

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

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PRIMARY COMMODITY PROCESSING IN
THE SECOND-TIER SOUTH-EAST ASIAN
NEWLY INDUSTRIALIZING COUNTRIES**

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No. 136

June 1998

DISCUSSION PAPERS

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* Tel. 022-907.5733; Fax 907.0274; E.mail: [nicole.winch@ unctad.org](mailto:nicole.winch@unctad.org)

ECONOMIC DIVERSIFICATION AND PRIMARY COMMODITY PROCESSING IN THE SECOND-TIER SOUTH-EAST ASIAN NEWLY INDUSTRIALIZING COUNTRIES

Jomo K.S. and Michael Rock

Instead of simply relying on static comparative advantage considerations, the governments of the three second-tier South-East Asian newly industrializing countries of Indonesia, Malaysia and Thailand have all intervened to diversify their economies. Such diversification has included the promotion of new crops (e.g. oil palm) and natural resource exploitation, i.e. diversification of primary production, as well as the promotion of manufacturing. Besides import-substituting and export-oriented manufacturing, primary commodity processing and resource-based manufacturing more broadly have been very important for the industrialization of these countries. Malaysia's palm-oil refining, Thailand's agro-processing and Indonesia's plywood manufacturing have figured significantly in their development of internationally competitive industrial capabilities.

INTRODUCTION

The second-tier or second-generation South-East Asian newly industrializing countries (NICs) of Indonesia, Malaysia and Thailand have been distinguished from the first-tier East Asian economies (NIEs) of Hong Kong, the Republic of Korea, Singapore and Taiwan Province of China as well as Japan on a number of grounds, including the resource wealth of the former in contrast to the resource poverty of the latter. South-East Asian resource wealth, it has been argued, made possible rapid economic growth on the basis of primary production, and thus weakened the imperative to industrialize. As much of this primary production was for export, such resource wealth also weakened the imperative to manufacture for export. Thus, resource wealth is seen by some as a "resource curse", weakening the imperative to industrialize, especially for export. This argument is invoked to explain the second-tier South-East Asian NICs later and slower industrialization (compared to Japan and the first-tier NIEs), as well as the allegedly lower emphasis on exports.

Thus, many observers - most recently Jeffrey Sachs and his colleagues in the *Emerging Asia* study published by the Asian Development Bank (ADB, 1997) - now suggest that being a natural resource-rich country is bad for growth. Curiously, the ADB study defines natural resource abundance in terms of the ratio of net primary product exports to GDP in 1971, without distinguishing between extractive natural resources (especially minerals) from agricultural products. The so-called "Dutch disease" mainly involves the former, which tends to be very capital-intensive and only involves a small proportion of the population

in the extraction of the resource. Consequently, the added income accrues to a few, while the appreciation of the country's currency affects the entire population.

Agricultural exports generally involve much more of the population, and increased income usually accrues to all producers, diffusing the adverse consequences of currency appreciation. The South-East Asian high performing economies have been major agricultural exporters, thus offsetting the problems associated with the mineral exports of Malaysia and Indonesia, in sharp contrast to, say, Nigeria. Generally, good macroeconomic management has also helped, especially in offsetting the tendency to indulge in expenditure on non-tradables.

Citing Lindauer and Valenchik (1994, pp. 288-9), Intal (1997) has argued that the marginal labour productivity, and hence the opportunity cost of farm labour for manufacturing, is higher in land-abundant African economies compared to land-scarce Asian ones, even though average labour productivity is usually higher in the latter. Thus it is unlikely that the former will be able to compete with the latter in labour-intensive manufactures. The Malaysian experience suggests that such labour-scarce, land-abundant economies can only be competitive in skill-intensive, rather than unskilled, labour-intensive manufactures, requiring considerable investments in human resource development.

Comparing wage rates to labour productivity in manufacturing for 1992, Intal (1997, table 4) shows the high proportion of wages and salaries to value addition per worker in economies such as Hong Kong (0.51), India (0.39) and Singapore (0.34) compared to Malaysia (0.28), the Republic of Korea (0.26), the Philippines (0.23), Sri Lanka (0.19), Thailand (0.15 in 1990) and Indonesia (0.14). This suggests that the low wages received by Indian workers do not automatically translate into labour-cost competitiveness. The situation in much of Africa suggests that, not unlike Indian labour, African labour may also not be competitive in wage/productivity terms.

The "tropical curse" thesis has also been resurrected by the Asian Development Bank (ADB, 1997). Surprisingly, the study seems to be oblivious to Lewis's (1969, 1978) pioneering work on the economic condition of the tropics. Lewis (1978) showed that tropical exports grew faster than temperate zone exports during the last period of global liberalization from the end of the last century. While the tropics generally had more modest export bases than the temperate zone, it implies that the tropics were able to respond to export demand despite the disadvantages they faced. Lewis emphasized, however, that not all tropical countries were able to seize the opportunities from increased export demand. He suggests that the exports in greater demand were largely water-intensive; hence, only those areas with enough water to substantially increase their exports were able to take advantage of the new opportunities. The more arid tropical grassland areas thus could not benefit from the increased demand for tropical products. It is also important to note that Lewis observed that the terms of trade for tropical exports had deteriorated badly against temperate exports. This suggests that productivity gains in the tropics were largely lost to

the worsening terms of trade, and the situation would have been even worse where few productivity gains were made.

As the South-East Asian NICs and some other tropical countries have grown rapidly since the 1960s, it is necessary to explain why countries in the tropics have fared so badly in the last few decades. It is not enough to simply attribute the tropical growth shortfall to “pests, diseases, typhoons and other natural calamities”, as the ADB study does, although such factors may not have been unimportant.

Against this background, this paper will show how the second-tier NICs successfully diversified the range of their primary exports and also developed processing capacities to increase retained value-added. As this paper will show, such diversification and development of resource-based industrialization did not always come easily, usually requiring government intervention to facilitate the process. Such a discussion implies that the South-East Asian NICs went beyond static comparative advantages derived from natural resource endowments to develop new capabilities through learning, productivity growth, externalities and scale economies. Some South-East Asian governments have captured and deployed resource rents to support policies enhancing new productive capabilities and capacities as well as international competitiveness, while some firms have invested their resource wealth to develop new internationally competitive capacities.

The story in South-East Asia is quite varied, emphasizing the importance of careful and judicious targeting and organization to ensure the efficacy of public policy as well as private initiatives. Hence, we provide some detailed description of policy initiatives – including firm and industry-level measures – used to encourage primary product diversification and processing. These include “functional” interventions, such as physical and social infrastructure support, as well as research and development (R&D) and training, policies aimed at boosting private domestic investment (including foreign direct investment), fiscal measures, subsidies, preferential credit, procurement policies, etc. We shall also show how export promotion and other policies were used to diversify exports, i.e. to promote non-traditional exports. Finally, some attention will be given to the role of primary sector institutional reform, particularly in designing, implementing and monitoring policies.

This paper proceeds in two stages. Because conventional wisdom exerts substantial influence on the way economic policy-making is viewed, our discussion departs from the conventional interpretation by offering an industrial policy interpretation of the three South-East Asian governments’ economic diversification policies. The focus here is on demonstrating how natural resource riches were used as part of an overall development strategy to diversify the economies away from dependence on primary products. The contention will be that if these South-East Asian governments had not intervened selectively and effectively to do this, they would not be second-tier NICs today.

MALAYSIA

The colonial Malayan economy grew rapidly from the late 19th century to become the single most profitable British colony. Access to agricultural land as well as to forest, mineral and other natural resources increasingly came under the control of the State during and after the colonial period. Peasant agricultural settlement from neighbouring islands was encouraged by offering easy access to cultivable agricultural land. The colonial authorities generally allocated land and other natural resources to favour British investors, ostensibly because they were better financed. Favouring big British capital could have been efficient in so far as there may have been significant scale economies. However, this was certainly not the case in the tin industry during the 19th and early 20th centuries before the advent of the dredge, or of the rubber economy during the colonial era (Jomo, 1986).

Infrastructural development – in the form of roads, ports, railways, telecommunications, electricity and water supply – favoured British interests. Malaysia's economic infrastructure (e.g. railways, roads, ports, utilities, etc.) – so crucial for profitable investment – was generally more developed than in almost any other British colony. Ethnic Malays remained largely marginal to the growing capitalist sector, with the elite integrated into the colonial State apparatus, and the masses remaining in the countryside as peasants. Instead, emerging business opportunities were mainly taken by some of the more urbanized and commercially better-connected Chinese. However, local businesses often found it more profitable to engage in production for export, commerce and usury.

The tin boom after the decline of Cornwall in the second half of the 19th century, and then, the decisive dominance of British dredging as well as the rubber boom with the growth of the motor car industry from early on in this century secured this position. In the half-decade after the end of the Second World War, colonial Malaya contributed more export earnings to the British Empire than any other part of the empire, including Britain itself. However, tin mining, rubber plantations and international trade continued to be dominated by British-owned agencies after independence until they were bought back, mainly by Malaysian State-owned enterprises, in London between the mid-1970s and the mid-1980s. Some have since diversified considerably into real property development, financial services, and resource-based as well as import-substituting manufacturing, and also abroad.

Although the Malaysian economy has changed significantly since independence, the many existing differences reflecting uneven development can be traced to the crucial formative decades under colonial rule that shaped Malaysia's economic structure. Helped by favourable commodity prices and some early success in import-substituting industrialization, the Malaysian economy sustained a high growth rate with low inflation until the early 1970s. Malaysia's export-led growth record in the last century has been quite impressive. During colonial times, Malaya was, by far, Britain's most profitable colony, credited with

providing much of the export earnings that financed British post-war reconstruction. Only a few industries were allowed to develop by the colonial authorities, which generally considered the colonies as suppliers of raw materials and importers of manufactured goods. Most industries then were set up to reduce transport costs of exported or imported goods, such as factories for refining tin-ore and bottling imported drinks. Local industries developed most when economic relations with the colonial powers were weak, e.g. during the Great Depression and the Japanese Occupation.

Tables 1 and 2 illustrate some macroeconomic trends in the Malaysian economy in the post-colonial period, showing rapid growth as well as structural change (table 1) and the rapidly changing composition of exports (table 2). After independence in 1957 and especially during the 1960s, the Malaysian economy diversified from the twin pillars of the colonial economy, i.e. rubber and tin. The Malaysian economy continued to experience rapid economic growth following independence. The average annual growth rate of the gross domestic product (GDP) in Peninsular Malaysia was 5.8 per cent during 1957-1970 (Rao, 1980). Later, the GDP for the whole of Malaysia rose by an average of 6.9 per cent per year between 1971 and 1990 (Malaysia, 1991) and by over 8 per cent annually from 1988. Malaysia's considerable export earnings ensured that it did not suffer from shortages of either savings or foreign exchange, contributing to investments, growth and structural change.

Table 1

Malaysia: gross domestic product by sector, 1960-1995
(percentage)

	1960 ^a	1970	1980	1990	1995
Agriculture	40	31	23	18	14
Mining	6	6	10	10	7
Manufacturing	9	13	20	26	33
Others	45	50	47	46	46
Total	100	100	100	100	100

Sources: Alavi, 1987, p. 14; Malaysia, Ministry of Finance, *Economic Report* (various issues).

a Peninsular Malaysia only.

Primary commodity production continued to dominate the economy in the early years following independence. However, in view of colonial Malaya's heavy dependence on rubber and tin export earnings, following sharp rubber price fluctuations during the 1950s and declining rubber prices in the 1960s, and in anticipation of the inevitable exhaustion of tin deposits, diversification of the economy after independence seemed imperative. However, economic diversification remained limited before the 1970s. Thus, despite the promotion of import-substituting industrialization and the uncertainties that over-dependence on tin and rubber production posed for the economy, these commodities remained the mainstays of the country's economy at the end of the 1960s. From 1951 to 1969, in spite of declining rubber exports owing to falling prices among other reasons, rubber and tin still accounted for almost 80 per cent of Malaysia's gross export earnings (Lim, 1973, p. 122). However, continued dominance by foreign capital meant that the surplus generated was often channelled overseas.

Table 2

Malaysia: export structure, 1960-1994
(percentage)

	1960	1965	1979	1975	1980	1985	1990	1994
Agriculture	66.1	54.5	59.5	52.8	43.6	32.7	22.3	14.2
Rubber	55.1	38.6	33.4	21.9	16.4	7.6	3.8	1.9
Timber	5.3	9.6	16.5	12.0	14.1	10.3	8.9	4.5
Palm oil	2.0	3.1	5.3	15.4	10.3	11.8	6.2	5.8
Others	3.7	3.3	4.0	3.5	2.8	3.0	3.4	2.0
Mining	22.0	30.0	25.9	22.6	33.8	34.0	17.8	6.4
Tin	14.0	23.1	19.6	13.1	8.9	4.3	1.1	0.4
Petroleum	4.0	2.3	3.9	9.3	23.8	22.9	13.4	4.2
LNG	—	—	—	—	—	6.0	2.8	1.6
Others	4.2	4.6	2.4	0.2	1.1	0.8	0.5	0.3
Manufactures	8.5	12.2	11.9	21.4	21.6	32.1	59.3	78.2
Other exports	3.2	3.3	3.0	3.2	1.0	1.2	0.6	1.2
Total exports	100.0							

Sources: Bank Negara Malaysia, *Annual Report* (various issues).

In 1957, the primary sector (agriculture and mining) accounted for 45 per cent of the GDP, the tertiary sector (services) for 44 per cent, and the secondary sector (manufacturing and construction) for

only 11 per cent. By the late 1960s there had been little structural change in the economy, in terms of both relative production shares and employment. Efforts were stepped up to diversify agricultural exports in the early 1970s. Oil palm and cocoa production, for example, were encouraged with crop-specific incentives, with Malaysia going on to become the world's largest exporter of both agricultural products. Thus, Malaysia extended its colonial global pre-eminence in rubber, tin and pepper to palm oil, tropical hardwoods and cocoa, i.e. through diversification of primary-sector production. In the mid-1970s petroleum production – off the East Coast of Peninsular Malaysia – began providentially, as oil prices soared from 1973. Since the early 1980s, petroleum gas production – almost exclusively for export to Japan – has come on stream, offering yet another primary commodity engine for the future growth of the Malaysian economy. Petroleum exports have thus been growing from the mid-1970s, and petroleum gas as well as cocoa production have become increasingly significant since the early 1980s. The openness of the Malaysian economy has also been sustained by Malaysia's new industries since the late 1960s, which have been largely export-oriented.

While biased and conservative, post-colonial rural development efforts contrasted with British colonial neglect, especially in the pre-war period. Initially, such government efforts were aimed at consolidating a politically loyal Malay yeoman peasantry for counter-insurgency purposes in the late colonial period and to capture the rural Malay vote after independence. Neither the colonial or post-colonial Malayan governments introduced reforms similar to the far-reaching redistributive land reforms which occurred in China, Viet Nam and North Korea¹ after communist-led revolutions, or the cold-war-inspired, system-preserving, redistributive land reforms of the late 1940s and early 1950s in Japan, South Korea and Taiwan.² Yet, in the face of a communist-led insurgency from the late 1940s, the colonial government initiated many reform measures in the early and mid-1950s, which were subsequently elaborated upon by the post-colonial regime to consolidate its rural electoral base.

In 1951 the colonial government established the Rural Industrial Development Authority (RIDA) under the leadership of Dato Onn Jaffar, the founding president of the United Malays National Organization (UMNO). Onn had left the party to form the multi-ethnic Independence of Malaya Party (IMP), apparently in response to a British condition for achieving independence. Later, various reforms were introduced to promote rural cooperatives and to limit rents charged for rice land tenancy as well as interest charged on credit loans. In the pre-war period, the government had restricted Malay land sales

¹ References to "North Korea" and "South Korea" are to be construed as referring to the regions prior to the country's partition following the Korean War (1950-1953).

² Reference to "Taiwan" is to be construed as referring to the region prior to 1949.

to non-Malays. It had also initiated research by the Rubber Research Institute (RRI) to enhance the agronomic, technical and other aspects of rubber production and use.

In 1952 the government established the Rubber Replanting Fund financed by a CESS (tax collected for a fund for specified uses) imposed on rubber exports. This facility was introduced in response to a recognition of widespread reluctance to replant less productive rubber trees owing to the tree removal and replanting costs involved as well as opportunity costs caused by the temporary loss of income. By providing replanting grants according to the area being replanted, the Fund facilitated and encouraged replanting, thus also arresting declining productivity in rubber production. However, plantations and large smallholdings (defined as being less than a hundred acres in area) were able to better utilize the facility as they could more easily afford to allow particular areas to be replanted while working the rest of the planted area. For smaller smallholdings that did not have other land to continue working on, the opportunity costs seemed greater, resulting in much less replanting by such smallholders. In response, the government set up the Rubber Industry Smallholders Development Authority (RISDA), which has provided larger replanting grants to smallholders and facilitated replanting in other ways. The more recent demand for rubber wood as commercial timber has also encouraged replanting. However, many rubber smallholdings and other farms have been left idle since the 1980s, as the smallholders have aged and their children secured employment outside the farm sector. As a consequence, productivity on smallholdings is now significantly lower than on plantations.

In 1956 the Federal Land Development Authority (FELDA) was established to open up new agricultural land for cultivation by landless settlers. FELDA was to open up millions of acres of land in Peninsular Malaysia during the next three decades planted with rubber, oil palm and other crops. The management of these FELDA land development schemes has changed considerably over time, involving various experiments ranging from simple supervision of smallholding operations to virtual plantation-style management by workers who are also settler-shareholders. Despite such variations in crop type, management and other conditions, as well as various controversies, FELDA has successfully used public resources (land, capital) to significantly expand agricultural production to the advantage of the settlers and with some degree of public accountability. While the former might have been achieved through private investments alone, the consequences are likely to have been more inequitable and hence more likely to be politically destabilizing.

Since the early 1980s, however, more emphasis has been given to the development of commercial agriculture – involving larger farms using more profitable, productivity-raising and cost-saving modern management methods – for export markets. While there has not been any spectacular increase in agricultural production in recent years, except for those due to technical advancements, there has been

a significant relative as well as absolute decline in the agricultural labour force, although official statistics underestimate the presence of foreign labour, especially of undocumented workers.

Rents in Malaysia have been created and allocated in ways so as to encourage investments in new productive activities, which have accelerated the diversification of the economy from its colonial inheritance. Much of this has emphasized economic diversification, especially industrialization, initially on the basis of import substitution, then export promotion, as well as heavy industrialization. Another important goal of rent creation and deployment in Malaysia has been redistribution, especially along inter-ethnic lines, though the economic effects of redistributive State interventions; these have generally been quite different from those intended to enhance structural change and economic diversification, but also more varied.

The availability of natural resource rents – most notably from petroleum, natural (petroleum) gas, tin, timber and agricultural products – has been very significant for growth, exports, savings, investment, government revenue and fiscal capacity, allowing the government greater latitude and capacity than most other governments in the world. It is important to consider the nature and fate of different types of resource rents by comparing what has happened to those from petroleum and logging.

The Petroleum Development Act (PDA) of 1974 has enabled the federal government to successfully capture much of the resource rents from petroleum and natural gas resources, providing a modest proportion to the governments of the State where the deposits are located. The PDA gave the federal authorities jurisdiction over petroleum resources, unlike other natural resources - including land, water, forests and minerals - which have been State government prerogatives under the post-colonial federal constitution. In the mid-1970s, petroleum production off the East Coast of Peninsular Malaysia began providentially, as oil prices soared after 1973. Although petroleum had long been extracted by Shell off Sarawak, Malaysia only became a net oil exporter from the mid-1970s. Since the early 1980s petroleum gas production - almost exclusively for export to Japan - has come on-stream. While petroleum royalties are shared with the State government concerned, the federal government controls Petronas as well as other petroleum revenues. Petronas is widely considered to be a well-run company, with a good international credit rating.

Petronas resources have been exploited for various purposes, including salvaging the State-owned Bank Bumiputera on two occasions to save it from “going under” and to buy into major real property construction projects of dubious commercial feasibility. These have done little to enhance productivity, but have instead served to prop up problematic government projects and to “save” protected and non-tradable economic activities or international competitiveness. However, all this has only been possible because the company has been able to capture and retain petroleum rents reasonably well, in sharp contrast to the situation with logging.

In the case of timber, by contrast, almost nothing has been captured by the federal government and relatively little by the State governments, which control all land and natural resources other than petroleum and natural gas since the PDA. Timber rents have mainly been captured by powerful politicians, royalty and others who secure logging concessions, as well as by their mainly ethnic Chinese logging operator partners and, frequently, by Japanese *sogosha* (general trading company) financiers. It should not be forgotten that rent-seeking occurs in essentially oligopolistic environments, ensuring that rents are not all dissipated in the process because of political “entry barriers” and that net gains are handsome enough to be very attractive. Such rents have not been restructured to reward productive and productivity-enhancing investments until recently, when bans on log exports encouraged investments in wood processing, with generally inefficient outcomes owing to the manner in which the incentives have been structured (Vincent and Hadi, 1992).

The authorities do not tax much either the timber concessionaires or the logging companies, certainly not even enough to cover the real costs of reforestation and for strict enforcement of logging and other related regulations. Timber companies hardly pay income tax, while the State governments collect a small royalty on the logs extracted, amounting to barely one per cent of the timber price. Loggers minimize their tax liabilities by undervaluing both the type, nature and quality of the timber extracted, as well as its quantity, volume and weight. Underdeclaration of wood extracted and exported is common, while accounts are “fiddled” or officials bribed to reduce tax and royalty liabilities and to maximize retained earnings. As the federal and State governments realize that timber revenues have been well below what they should be, tax rates have been raised, but often only to lead to further tax evasion.

With few taxes to pay and poor enforcement by the authorities, the loggers seek to maximize short-term, rather than long-term returns, especially with the political uncertainties which threaten policy change and the security of their concessions. Having no stake in the forest’s regeneration owing to the generally short-term nature of logging concessions and sub-contracting arrangements with the loggers by the concessionaires, the logging industry has been short-termist, and largely oblivious of the requirements of sustainable forestry practices. Much illegal logging - outside concession areas, of immature trees, etc. - occurs, while logging companies often disregard restrictions for selective felling in order to maximize profits in the short term.

Loggings contribution to Malaysian capital accumulation; investment and growth has been limited in other ways too. Underdeclaration of timber production and exports has not only facilitated tax evasion, but also capital flight. Many of the beneficiaries have not even reinvested within the country, let alone in the areas from which the timber has been extracted. Thus, logging has exacerbated resource outflows, not only for the communities directly affected but also for the national economy. Despite the considerable

money made from logging, both State and federal governments get relatively little while they are obliged to bear some of the environmental and other costs of deforestation.

Not unlike many African countries, Malaysia's resource wealth and relatively small population enabled the public sector to grow in the 1970s and early 1980s with a "soft budget constraint", which not only allowed but even encouraged various extravagances. Despite some dissipation as well as rent capture by dubious *rentiers* unlikely to make productivity-enhancing investments, such resource wealth and Malaysia's relatively small population enabled the public sector to develop in the 1970s and early 1980s with a "soft budget constraint", which not only allowed, but even encouraged various extravagances. Such fiscal irresponsibility seemed to increase with greater State intervention and the availability of enhanced oil revenues from the mid-1970s until the economic and political crises of the mid-1980s brought about greater fiscal discipline and harder public enterprise budget constraints, besides providing a rationale for privatization.

By East Asian standards, Malaysia has had one of the highest household savings rate, second only to Singapore. The main reason is a provident fund institution for common employees requiring all workers and their employers to contribute the equivalent of between 20 to 30 per cent of their wages to a fund which later becomes available upon retirement or for other designated purposes. This forced savings institution has also been important as an alternative to "pay as you go" pension fund arrangements, which have become very burdensome and almost unsustainable in mature welfare States.

Malaysia's manufacturing growth has been facilitated by both import-substitution (IS) and export-orientation (EO) industrialization policies. Both IS and EO industries have gained from protection and subsidies respectively, e.g. EO rents attracted foreign transnationals to invest in the processing of imported inputs for re-export. Various rents – offered in the form of financial (especially tax) incentives, low wages, good infrastructure, political stability and government support – have attracted risky lumpy investments in export processing, and even in some design activities since the 1980s. Like import substitution, export orientation has also involved distorting relative prices, contrary to the claims that export success has been due to *laissez-faire* market policies.

Though Malaya was, by far, Britain's most profitable colony, only a few industries were allowed to develop by the colonial authorities, which generally considered the colonies as suppliers of raw materials and importers of manufactured goods. During the colonial period, some such industries enjoyed "natural protection" owing to the nature of the raw materials produced (e.g. rubber latex requiring immediate processing near the point of extraction). Most industries then were set up to reduce transport costs of exported or imported goods, such as factories for smelting tin ore, processing smoked rubber sheets to reduce rubber's natural liquid content and bottling imported drinks. Not surprisingly then, local industries

developed most when economic relations with the colonial powers were weak, e.g. during the Great Depression and the Japanese Occupation.

Resource-based industrialization was the great hope for post-colonial Malaysia, whose growth during the colonial period had been based on primary production. After independence, for example, it was expected that Malaysia, as the world's largest natural rubber producer, would be placed to become a significant producer and exporter of rubber manufactures, such as car tyres. Ironically, because of the low natural rubber content and high synthetic rubber content of most car tyres as well as the different effectiveness of industrial policies, the Republic of Korea (which does not produce any natural rubber or petroleum, from which synthetic rubber is made) - rather than Malaysia - emerged in the 1980s as a major rubber tyre producer and exporter.

Inexperienced rubber tyre manufacturers in the Republic of Korea were initially protected on condition that they would export within a few years, which they did with great success. Having to export forced the tyre manufacturers to quickly minimize costs, maximize scale economies and raise quality to international standards. In Malaysia, however, foreign tyre manufacturers were granted protection to induce them to set up a plant to produce for the domestic market. While the government hoped that they would eventually export, it did nothing to require them to do so, although it offered attractive incentives and support facilities in the hope that they would do so. These transnational tyre manufacturers eventually began exporting, but their achievement has been modest given the amount of protection they have enjoyed in terms of both the duration as well as the effective rate of protection. Exports were initially of tyres with a high natural rubber content (e.g. aircraft tyres), and have grown most since the ringgit depreciation in the second half of the 1980s. The differences in the performances of the rubber tyre industries in the Republic of Korea and Malaysia clearly reflect the consequences of appropriate and effective industrial policy measures.

As noted earlier, as part of its measures for agricultural diversification, post-colonial Malaysia promoted increased palm oil production from the 1960s, especially in the face of lower, often depressed rubber prices. The nature of the crop and transport cost considerations required the domestic extraction of crude palm oil from the palm fruit before export. However, palm oil producers and other investors were unwilling to invest in palm oil refining before the mid-1970s. Returns to such investments were not expected to be high enough to warrant them. Also, many importing countries imposed higher import duties on refined oil to protect their own refining capacities, and effectively discouraged investments in such capacity abroad, including in Malaysia.

However, a higher export duty on crude palm oil exports introduced in Malaysia in the mid-1970s attracted massive investments in its processing capacity, which soon led to very intense competition among refiners. This forced refiners to enhance their industrial and technological capabilities rapidly,

enabling Malaysia to reach and then define the world technological frontier in palm oil refining within a decade. The rapid development of such capabilities was facilitated by the achievement of new economies of scale and scope (e.g. specialized rather than generic vegetable oil processing). In the face of new protectionist barriers erected by traditional importers who wished to promote the consumption of their own vegetable oils, the Malaysian government also did a great deal to promote palm oil exports to new markets. In some instances, the Malaysian authorities have even encouraged the potential importers to develop palm oil refining capacities in the importing countries, effectively committing them to future imports of the oil, presumably from Malaysia.

This story provides a splendid illustration of how government intervention, involving a temporary welfare loss for crude palm oil producers (owing to the export duty equivalent which would accrue to the refiners), led to considerable net welfare gains for all major segments of the palm oil industry, and significant gains in value-addition for the national economy. It also underscores the importance of a dynamic perspective on comparative advantage, instead of the static view associated with neo-classical international trade theory.

However, efforts to increase manufacturing value addition in Malaysia have not always been well considered. For example, bans on log exports have been imposed at various times in Peninsular Malaysia, Sabah and Sarawak with the ostensible intention of promoting wood-based manufacturing activities in Malaysia. While such activities have certainly grown, much of the existing capacity is quite inefficient and would not survive without the log export ban. More importantly, there is little evidence that most of these industries are ever going to become internationally competitive, meaning that they constitute a welfare loss, particularly for the timber producers who receive lower prices for their timber due to the market constraint imposed by the log export ban.

The government has become more selectively interventionist since the mid-1980s, even withdrawing in some areas in line with its commitment to economic liberalization, thus giving an overall impression of an incoherent industrial policy. The period since the mid-1980s has also seen new efforts by the government to encourage technological deepening by foreign capital. Rents have been increasingly tied to the development of domestic production capabilities, rather than simply to investment and employment generation, as was the case before the mid-1980s. Human resources, research and development, linkages, exports and technologically strategic manufactures all enjoy additional tax incentives.

THAILAND

Between 1955 and 1988, per capita economic growth in Thailand averaged 3.9 per cent per annum (Christensen et al., 1993, p. 2). Only five economies – Brazil, China, Malaysia, the Republic of Korea and Taiwan Province of China – grew faster. High economic growth was accompanied by a rapid decline in the incidence of poverty, mild but rising income inequality, and substantial exports of both manufactures and primary commodities, including processed agricultural commodities.³ By 1985 the value of manufactured exports exceeded agricultural exports for the first time.⁴ Textile exports increased fourfold between 1983 and 1989; integrated circuits exports doubled between 1985 and 1987, while exports of plastics and shoes more than doubled in 1988 alone. There was a similar boom in processed commodities. They had stagnated between 1981 and 1986, but grew rapidly after that, increasing by more than two and a half times by 1993 (tables 3 and 4). This export boom (largely based on foreign investment) contributed to an acceleration of growth of up to 6.4 per cent per capita per annum between 1989 and 1992.⁵

Table 3

Thailand: changes in production structure, 1960-1993
(GDP share in percentages, selected years)

	1961	1970	1980	1990	1993
Agriculture	39.8	27.0	20.0	13.6	11.8
Industry	18.7	24.4	30.1	37.8	40.8
Services	41.5	48.0	49.9	48.6	47.4
Manufacturing	12.6	16.0	21.7	27.8	31.1
Total	100.0	100.0	100.0	100.0	100.0

Sources: National Economic and Social Development Board and Bank of Thailand.

³ The incidence of poverty declined by 56 per cent between 1962 and 1986 (World Bank, 1990, p. 41). The Gini coefficient rose from 0.41 in 1962/63 to 0.47 in 1981 (Fields, 1991, p. 21).

⁴ This observation and those following on manufacturing exports are drawn from Unger (1991, p. 8).

⁵ Between 1986 and 1989 annual foreign direct investment flows and exports more than doubled (IMF, 1991, p. 715).

This long-term development performance has made Thailand one of the development success stories since 1960. Not surprisingly, the World Bank also included it among the eight highly performing Asian economies (HPAEs) in its *East Asian Miracle* study (World Bank, 1993). Conventional neo-liberal wisdom attributes Thailand's success to getting the basics right. Successive governments have maintained macroeconomic stability, got prices right, provided public goods (infrastructure, education, public health and family planning) and left growth to the private sector. When policy-makers deviated from *laissez-faire*, as they did with industrial policy, the interventions were limited, incoherent and characterized by rent-seeking. The usual explanations conclude that it was ultimately irrelevant to Thai performance (Christensen et al., 1993, pp. 3 and 7).

Table 4

Thailand: structure of exports, 1981–1993
(Percentage of total exports)

	1981	1985	1988	1990	1993
Agriculture:					
Rice	17	12	9	5	4
Tapioca	11	9	5	4	2
Total	48	38	26	17	12
Labour-intensive manufactures:^a					
Textiles and garments	10	14	16	16	14
Jewellery	3	4	6	6	4
Footwear	0	1	2	3	3
Total	15	21	29	31	27
Medium-high technology manufactures:					
Machinery and appliances ^b	0	1	4	8	10
Electrical	0	1	2	6	7
Electrical circuitry ^c	4	4	7	6	8
Vehicles and parts	0	0	1	1	2
Total	5	7	15	22	30
Manufactures as percentage of total exports					
	36	49	66	75	80
Total exports	100	100	100	100	100

Sources: Wiboonchutikula (1987); Bank of Thailand.

a All other categories (other agriculture, other labour-intensive, etc.) have been omitted.

b Mainly computers and parts.

c Mainly integrated circuits.

The standard interpretation of the Thai State seems to offer an internally consistent and powerful explanation of the irrelevance of Thai industrial policy. The focus on rent seeking “feudalization” of government administration leads many observers to overlook important contrary evidence of highly effective, longstanding and significant selective distortions in agricultural markets. This causes them to miss equally important examples of successful selective interventions during first-stage import substitution industrialization (ISI) in the 1960s as well as second-stage ISI in the 1970s. It also contributes to a critical oversight of the systematic turning of the entire industrial policy machinery to promote non-traditional manufacturing exports and non-traditional agro-industrial exports during the 1980s.

An important part of the neo-liberal interpretation of Thai industrial policy rests on an assertion of low price distortions. While the exchange rate, the interest rate and the price of capital were kept close to their scarcity values, this was not true for agricultural prices, particularly rice prices, and, by implication, the price of labour.⁶ These distortions were systematic, sustained over time, and large. What was the purpose of the government’s rice price policy and how did it intervene in rice markets?⁷ Except for occasional rent-seeking, government intervention in rice markets was aimed at stabilizing rice prices at a low level.⁸ This was achieved through a variety of taxes, including a variable export tax on rice. This policy had two important consequences. It facilitated substantial crop diversification (Panayotou, 1989, pp. 96-7). As shown below, this also contributed to the emergence of a large export-oriented agro-processing industry once the government began offering promotional privileges to large export-oriented agro-processors. This policy also enabled the government to take advantage of a large land frontier to manipulate the industrious, but politically docile peasantry by giving peasants access to land while taxing them heavily.⁹ As a result of the government’s systematic use of a variable export tax on rice for over 30 years, it was possible to extract resources from agriculture without impoverishing the peasantry, and

⁶ Because rice has been the primary wage good, government rice price policies have exerted substantial influence on the price of labour (Bertrand, 1980, pp. 45 and 79).

⁷ For a discussion of the Thai rice price policy, see Siamwalla (1975).

⁸ Between 1962 and 1980 the wholesale price of non-glutinous rice in Bangkok averaged about 75 per cent of the export price (World Bank, 1983, Vol. 2, p. 97). But this varied considerably from year to year, depending on the harvest and world markets. When world rice prices rose, signalling greater profits in exports, the Thai government intervened with a variable export tax to keep the price of rice in Bangkok stable. When export prices fell, the export tax on rice was lowered.

⁹ On the industriousness of the peasantry, see Keyes (1983). Piker (1976) discusses the role of the land frontier on rural social organization. Wong (1987, p. 72) estimated that approximately 7.8 per cent of national income was transferred out of agriculture annually by export taxes on rice through the 1960s. Bertrand (1980, pp. 45 and 79) concluded that between 1955 and 1966 taxes on rice were about 40 to 45 per cent of the export price and 80 to 85 per cent of farm gate prices.

to build an indigenously owned commercial banking system and an import-substitution industrial base in Bangkok behind protective barriers.¹⁰

In 1986 the government began promoting export-oriented agro-industries (Manarungsan and Suwanjindar, 1992, p. 13). These industries were chosen for promotion because all of their output was exportable, most of their raw materials were produced locally, they were labour-intensive, and they increased farmers' incomes (Suehiro, 1992, p. 268). Since then, promotional privileges for export-oriented agro-processing industries have included import duty reduction on machinery imports; three-year income tax exemption, extendible to seven years; exemption of import duties on raw or essential materials; exemption of export taxes; exemption of value-added taxes on exports and local goods used to produce exports; and reduced electricity charges, domestic air-cargo charges by Thai International, and rail charges if located in industrial estates in selective provinces (BOI, 1996, pp. 3-4; IEAT, no date, p. 7). Agro-processing industries have also benefited from the extension of subsidized credit to farmers who participate in contract farming and outgrowing schemes (Pasuk and Baker, 1995, p. 60); from promotional privileges extended to general trading companies (Hewison, 1989, p. 145); from bilateral intergovernmental negotiations with importing countries, resulting in lower tariffs on imports; and from a government programme designed to enhance the quality of agro-exports.¹¹

Although there are no definitive studies of the impact of promotional privileges on agro-processing industries and their exports, available evidence suggests that these programmes probably did make a significant difference. For one, processed agricultural exports grew at an annual average rate of 33.75 per cent between 1986 and 1993 (table 4). Moreover, by the late 1980s, 15 of the largest 26 non-financial domestic business groups were exporting processed agricultural commodities (Suehiro, 1992, p. 269). For prepared meat exports and primarily chicken meat exports, growth was even more dramatic. Prepared meat exports were practically non-existent prior to 1976; they equalled by 1980 \$32.7 million and by 1985 \$63.5 million. Following heavy promotion by the government, prepared meat exports increased eight-fold to \$434 million in 1993 (table 4).

The experience of the Charoen Pokpahan (CP) Group is typical of the expansion experienced by Thailand's agro-industries.¹² The CP group got its start in 1921 as a trading company importing seeds and vegetables, and exporting pigs and eggs. The company registered with the Thai government in 1951 and

¹⁰ On the development of the banking system, see Suehiro (1992, pp. 42-50). On the development of industry, see Suehiro (1992, pp. 50-57), and Narongchai (1973).

¹¹ As a result, the government of Japan lowered the tariff rate on chicken broilers by 14 per cent in 1986 (Manarungsan and Suwanjindar, 1992, p. 61).

¹² Unless otherwise noted, what follows is drawn from Hewison (1989, pp. 143-145).

opened a feed mill in 1954. With this mill the company took the first steps towards vertical integration as the group not only sold seeds to farmers but also bought and processed farmers' crops. In 1976 CP moved into poultry farming following an announcement by the Board of Investment (BOI) that promotional privileges were available for this activity. Because of difficulties breeding local chicken, CP entered a joint venture with an American company, Arbor Acres, which provided and continues to provide CP with chicks. CP also established joint ventures with Japanese firms to market frozen chicken meat in Japan (Manarungsan and Suwanjindar, 1992, p. 17). And it pioneered contract-farming in Thailand, including guaranteeing loans to farmers from the commercial banks and from the Bank of Agriculture and Agricultural Cooperatives (Pasuk and Baker, 1995, p. 60). By 1979 CP controlled 90 per cent of poultry exports and 40 per cent of the domestic animal feeds business. CP also used BOI privileges to establish its own trading company, CP Intertrade, and to establish plantations for growing mung beans and maize (Hewison, 1989, p. 145).

Given Thailand's rich natural resource base and overwhelming comparative advantage in agriculture, one would expect the share of value added in agricultural processing industries to be significantly greater than one and to deviate most from international norms. Yet, the actual share of value added in food, beverage and tobacco in Thailand in 1986 was only 34 per cent of its expected share (Hewison, 1989, p. 306). And this is the case despite the substantial success experienced by Thailand's large-scale agro-processing industries. Moreover, Thailand's overall manufacturing share of value added in GDP exhibits far greater deviation from international norms than that for any other HPAE, including the Republic of Korea.¹³ In three out of nine subsectors – textiles (3.33), wood and wood products (1.85), and metal products and machinery (1.82) – the actual value added was between two and three times that predicted by international norms. Taken together, these outcomes suggest that Thai industrial policy almost certainly exerted significant influence on industrial structure.

Conservative macroeconomic policies, consistent selective interventions in agricultural markets (including markets for agro-industrial exports), successful industry and firm-specific interventions during first-stage and second-stage ISI, and the systematic turning of the industrial policy machinery to promote non-traditional manufacturing exports during the 1980s suggest that industrial policy in Thailand has been more coherent than neo-liberals admit. When combined with an ability to avoid serious economic policy mistakes and the adoption of a statist transition to export-led industrialization following the failure to liberalize the trade regime along neo-liberal lines, the Thai government appears more, rather than less, like its counterparts in North-East Asia. This is not to say that its decision-making processes are as clear as

¹³ The actual share of manufacturing in value added in 1986 was 1.68 times international norms. This compares to 1.26 for the Republic of Korea and Hong Kong, and 1.38 for Singapore (World Bank, 1993, p. 327).

those in North-East Asia, particularly the Republic of Korea. But it is important not to confuse opaque, cumbersome, subject-to-delay, consensus-building policy-making processes with a rent-seeking feudalization of administration. Its time to recognize just how pragmatic, flexible and non-ideological the Thai State is.

Doing so requires substantial revision of thinking about the Thai State, particularly during the period when Prem was Prime Minister (1980-1988). It is increasingly clear that both he and the Secretary-General of the National Economic and Social Development Board (NESDB), Snoh Unakul, used the opportunity of economic crisis to restructure relations within the Thai State itself and between the State and the leadership of the business community. They followed this with a corporatist and statist approach to export-led industrial development. But all too little is known about this period. Why, for example, was Prime Minister Prem so willing to create the Joint Public and Private Sector Consultative Committee (JPPCC) and vest so much authority in NESDB? Although there have been several studies on the operation of the JPPCC during this critical period, not nearly enough is known. For example, what role, if any, did it play in turning the sectoral ministries into instruments of export-led industrial development?

Once thinking is reoriented to allow for the possibility of more effective selective government intervention; a new and wide range of other questions can be asked. As mentioned above, econometric work shows that export success cannot be explained by movements in the real exchange rate or by trade reform. If exchange rates and trade liberalization did not play large roles, what did? How much impact did the government's export campaign have on export success? How much impact did the Ministry of Commerce's Department of Export Promotion play? How critical were BOI promotional privileges, particularly those permitting majority/wholly owned foreign ownership for direct foreign investors who exported most, or all, of their output? What role, if any, did the government play in the rapid growth of textile and garment exports to non-Multi-Fibre Agreement (MFA) markets once Thai exporters exceeded their MFA quotas in Europe and the United States (Hill and Suphat, 1992, pp. 310-28)? What role, if any, has government policy played in technology transfer and technology upgrading?¹⁴ What role, if any, did industry-specific government-business councils and ministry-industry councils play in export success? Did they precipitate industry-specific or firm-specific interventions? Did any of this affect export-oriented agro-processors, particularly following the government's announcement of the Four-Sector Cooperation Plan to Develop Agriculture and Agro-Industry (Glover and Ghee, 1992, p. 13)?

¹⁴ There is some reason to believe that this may be important. As early as 1981, the Thais realized that technology-licensing agreements tended to limit or restrict Thai firms from exporting the products produced under licensing agreements (Mingsarn, 1981).

INDONESIA

Between 1965 and 1990 growth in income per capita in Indonesia averaged 4.5 per cent per annum (World Bank, 1992, p. 218). Only seven developing countries – Botswana, China, Hong Kong, Lesotho, Paraguay, the Republic of Korea and Singapore – grew faster. High economic growth was accompanied by a rapid decline in the incidence of poverty and low-income inequality (Campos and Root, 1996, pp. 9-16). In addition to equitable and poverty-reducing growth, Indonesia achieved food self-sufficiency (in rice by 1985), a rapid decline in the population growth rate, and an equally impressive spread of basic education and literacy (Campos and Root, 1996, p. 60).

These developments were accompanied by substantial industrialization and structural change. Agriculture's share in GDP has declined from 51 to 22 per cent, while the share of manufactures in GDP rose from 8 to 20 per cent (World Bank, 1990, p. 222). Because overall growth was so rapid and growth in manufactures even more rapid (manufacturing output grew by more than 12 per cent per year between 1965 and 1990), the manufacturing sector in 1990 was almost 45 times larger than it was in 1965 (World Bank, 1992, p. 222). Although much of manufacturing was fostered under policies of import substitution, Indonesia also experienced substantial success in exporting manufactures. By 1993 manufactured exports reached \$21 billion and accounted for 53 per cent of total exports (World Bank, 1996, p. 216). Because of this, Indonesia has gone a long way towards diversifying its economy, including exports, away from oil and other primary products (tables 5 and 6).¹⁵

Table 5

Indonesia: gross domestic product by sector, 1965-1990

	1965	1970	1980	1990
Agriculture	55.0	47.5	24.3	19.4
Manufacturing	8.5	10.9	13.4	19.4
Other industry	6.5	8.9	29.7	22.1
Services, etc.	30.0	32.7	32.1	39.1

Sources: Central Bureau of Statistics (BPS) and World Bank staff estimates, reproduced in Bhattacharya and Pangestu (1993).

¹⁵ Indonesia's export concentration index declined from 0.499 in 1984 to 0.194 in 1992 (World Bank, 1996, p. 192).

Table 6

Indonesia: major manufactured exports, 1980-1993
(US\$ million)

	1980	1985	1990	1993
Labour-intensive:				
Total	287	785	4,634	11,344
Major items				
Clothing	98	339	1,646	3,502
Woven fabrics	43	227	1,132	2,247
Footwear	1	8	570	1,661
Electronics	94	77	204	1,382
Percentage of all manufactures	57	38	51	58
Resource-intensive:				
Total	119	992	3,324	5,364
Major items: plywood	68	941	2,791	4,586
Percentage of all manufactures	24	49	37	28
Capital-intensive:				
Total	97	266	1,083	2,729
Percentage of all manufactures	19	13	12	14
Total, all manufactures	501	2,044	9,041	19,437
Three largest as percentage of total	52	74	61	53
Manufactures as percentage of total exports	2	11	35	53

Sources: BPS, *Ekspor* (Exports), Jakarta, various issues.

This long-term development performance has attracted considerable attention (World Bank, 1993; Campos and Root, 1996; Hill, 1996a). Broad similarities across the developing world with Indonesia's factor endowments (natural resources, physical capital and human capital) and with the character of its State (which is neither "strong" nor "hard" in the North-East Asian sense, and replete with corruption, rent-seeking and patrimonial distributional networks) suggest that other similarly placed governments might have much to learn from Indonesia (Lindauer and Roemer, 1993). The Indonesian government's relatively effective husbanding of its natural resource riches to promote broad-based growth and economic diversification is also of interest. As experience elsewhere shows, this has not proved easy, and all too often natural resource riches are a "curse" (Auty, 1990, 1994; Gelb and Glassburner, 1988) rather than a boon to development.

Conventional wisdom, represented by the World Bank (1993) and other studies (particularly Hill, 1996a, 1996b; Booth, 1989), attributes Indonesia's success to getting the basics right. Successive governments maintained macro-economic stability, got prices right, provided public goods (infrastructure, education, public health and family planning), and left growth to the private sector. When policy makers deviated from *laissez-faire*, as they did with industrial (Hill, 1996b), forest (Gillis, 1988) or credit policy (MacIntyre, 1993), the intervention was limited, incoherent and characterized by rent-seeking. Neo-liberals concluded these were ultimately irrelevant to Indonesia's development and export success (Hill, 1996b; MacIntyre, 1994).

The conventional interpretation of Indonesia's economic development appears to offer an internally consistent and powerful explanation of the irrelevance of selective (micro) policies. But the focus on a rent-seeking government at the micro (sectoral) level leads them to overstate the technocrats' commitment to neo-classical liberalism and the bifurcation between macro and micro policy. It contributes to an underestimation of the government's commitment and ability, including that of the technocrats, to use income from natural resource riches, including oil, to diversify the economy by financing "full-set industrialization" (Mihira and Sato, 1992). Because of this, neo-liberals miss substantial evidence that reveals rejection by the technocrats of a development strategy based on static comparative advantage in primary products, including oil. They also overlook important contrary evidence of the role of the technocrats in highly effective, long-standing, large and selective interventions in agricultural markets, particularly for rice. And they miss industry-specific examples of successful selective interventions during first- and second-stage ISI in the 1970s and in export promotion in the 1980s, including the establishment of resource-based industries.

To begin with, the neo-liberal interpretation overstates opposition by the technocrats to selective interventions in micro markets. Their statements and actions suggest otherwise; virtually all the leading technocrats have spoken out against the government taking a hands-off approach towards the micro-economy. One of the technocrats, Sadli, stated this clearly and explicitly (Glassburner, 1978a, p. 30). Another, Emil Salim, stated that the desire to guide the economy and eliminate liberalism (operation of free markets) emerged from the experience of colonialism, when "... the people suffered much from economic liberalism ..." (Glassburner, 1978a, p. 30). Yet another, Widjojo, attributed Indonesia's low income and income inequality to the operation of market forces (Glassburner, 1978a, p. 31). Because of this, he advocated sustained control over the volume and direction of investment to avoid structural debilities (Glassburner, 1978a, p. 31). This fear of markets also manifested itself in a very interesting debate among western-trained Indonesian economists concerning ostensibly original Indonesian economics, *ekonomi Pancasila* (McCawley, 1982, pp. 102-109). This fear of free markets expressed by technocrats reflected the view that Indonesia's long-run comparative advantage should not rest on primary products, particularly

oil (Gelb and Associates, 1988, p. 198). This is what happened during the colonial period, which led to an underdeveloped and dependent economy. Because of this, the technocrats have expressed interest in achieving an “appropriate level of economic nationalism” *cum* industrialization (McCawley, 1982, p. 103). They have not been opposed to using selective interventions to achieve this. The technocrats’ difference with engineers is that they want to do this by relying on “market-conforming” selective intervention methods.

Anti-free market statements by the technocrats have been backed up by actions. There are several clear examples of this. Despite objections from foreign advisors, the technocrats have insisted that all programme aid be channelled through government programmes (Glassburner, 1978a, p. 28). They have also insisted that private investment, particularly foreign investment, be subject to government licensing, according to a government schedule of priorities. Most importantly, there is growing evidence (Pack, 1994; Pangestu and Boediono, 1986) that technocratic control over import tariffs has been “made to order”, i.e. used to promote infant industries rather than for rent-seeking. This suggests more coherence to micro policy than neo-liberals admit.

But these examples are more suggestive than definitive and provide little direct evidence of technocratic influence over sectoral agencies and micro policies. The role of technocratic intervention in particular markets should therefore be examined. The starting point is intervention in agricultural markets, particularly the market for rice.¹⁶ There, intervention has been widespread, long-standing and highly effective. It has also required substantial coordination with sectoral agencies, particularly the Ministry of Agriculture as well as Bulog, the food logistics agency.

Because the history of government policy towards rice is well-known, only the outlines will be provided here (Timmer, 1975, 1989, 1993). Government interest in rice, most particularly self-sufficiency in rice production, is a consequence of a complex set of factors: President Suharto’s rural roots; recognition that increasing rural well-being is an effective antidote to agrarian radicalism; the macroeconomic consequences of importing large quantities of rice; the politically stabilizing effects of low and stable rice prices for urban consumers (particularly civil servants and the military), and for the pace of industrialization. For all these reasons, the government had committed itself to achieving self-sufficiency in rice (Glassburner, 1978b, p. 143). By 1985, this was achieved and it has been more or less sustained.

¹⁶ Successful intervention in rice markets stands in sharp contrast to what might be called benign neglect of the rest of agriculture, including estate crops (Hill, 1996, pp. 137-144).

Figure 1
Development expenditure as per cent of total government revenue

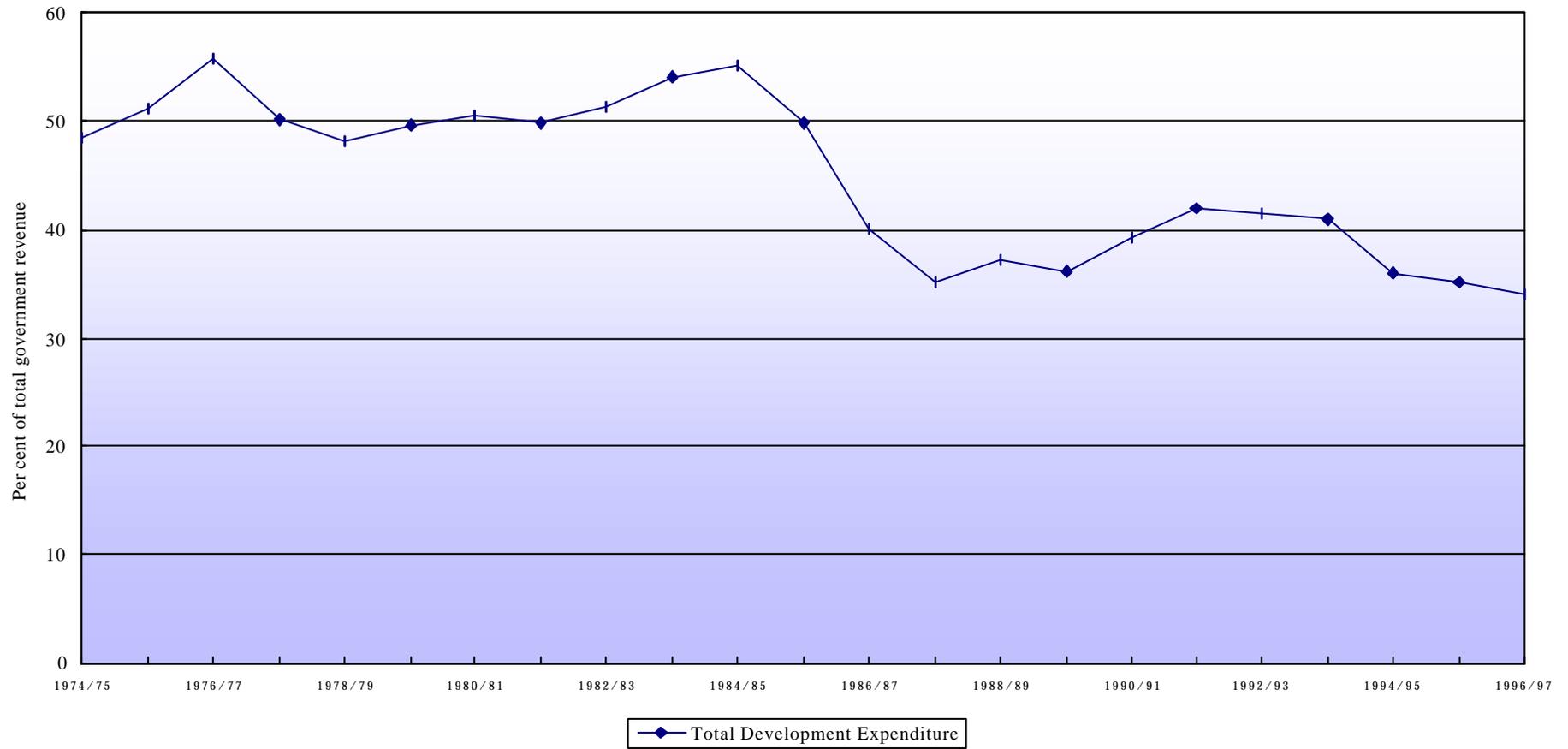
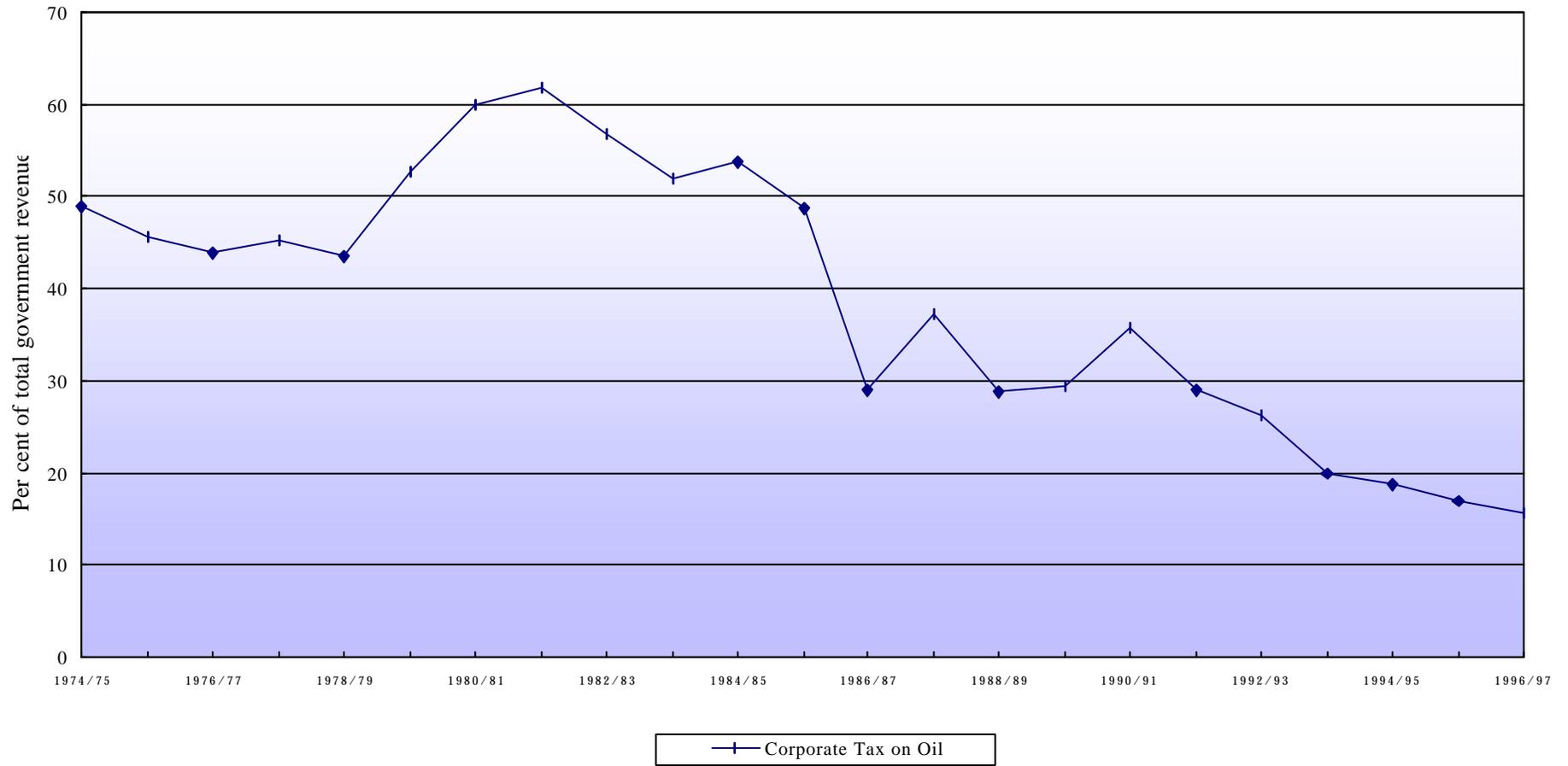


Figure 2
Corporate tax on oil as percentage of total government revenue



How was this done? The answer is simply by substantial intervention in markets for inputs (fertilizer, pesticides and seeds), credit markets and output markets. In each instance, the government deliberately distorted market prices. The objective of intervention in output markets was to stabilize the domestic price of rice around the world price (Timmer, 1993, p. 152). In fact, domestic rice prices were kept roughly 15 per cent below world prices (Gelb and Associates, 1988, p. 219), which meant, in actual practice, stabilizing rice prices around a declining real world price. Doing this required substantial coordination across several agencies, including: Bulog; BAPENAS, the planning agency, the Ministry of Finance; the Ministry of Agriculture; the President's Office; and EKUIN, the Coordinating Ministry for Economics, Finance and Industry (Timmer, 1993, p. 151). As Timmer states (p. 158), the Ministry of Finance was the key organizer of an analytical process that resulted in the government setting floor and ceiling prices and controlling imports. This gave one of the key macro agencies substantial influence over one of the key sectoral or micro agencies, Bulog. The government has consequently been highly successful at stabilizing rice prices around world prices (Timmer, 1993). These stable price signals were communicated to farmers, encouraging them (and others) to invest in marketed crops and agricultural marketing. It also provided stability of real wages (rice is the primary wage good) and contributed to urban political stability (by provisioning cities with low and stable prices for rice). Both probably induced investment growth in industry (Timmer, 1989).

However, this was not the only intervention in rice markets. Because farmers had limited experience with commercial fertilizer and high yielding seeds, the government subsidized both, as well as credit to farmers to enable them to purchase these new inputs.¹⁷ These subsidies were used to overcome failures in information markets (farmers did not fully understand the impact of new seeds and fertilizer on yields) by significantly improving output to fertilizer price ratios (Booth, 1989, p. 1243). Information failures were also addressed by an aggressive and publicly funded agricultural extension programme (Hill, 1996a, p. 129). Much of this was funded out of the revenue windfall that accompanied the oil price

¹⁷ Between 1968 and 1974 farmers received between 19 and 42 per cent of all central bank credit subsidies (MacIntyre, 1995, p. 150).

shocks of the 1970s.¹⁸ The government's highly successful selective intervention in rice agriculture made it possible to finance an indigenously owned import-substitution industrial base behind protective barriers.¹⁹

But precisely how did the government go about supporting "full-set industrialization"? After an initial effort to do this by selectively favouring *pribumi* (indigenous) entrepreneurs failed, efforts shifted to supporting a small number of *cukong* (Chinese businessman) entrepreneurs (Robison, 1986, pp. 41-47 and 133-144), who were favoured by their connections to political elites. Bias in government policies towards what were to become large Sino-Indonesian conglomerates took several forms. Initially, these firms gained preferential access to lucrative monopoly licenses and government contracts, and also had preferential access to subsidized credit. Government requirements for promotional privileges – such as BOI business tax exemptions on imported capital goods and raw materials, tariff protection on local production, and tax holidays – also favoured large firms. The preferential access of large firms to promotional privileges and subsidized credit were frequently combined with bans on new entry into promoted industries and removal of banned industries from eligibility for promotional privileges. The effect of this bias is the domination of Indonesian industry by large firms combined into a small number of family-centred conglomerates. By the mid-1980s, 55 per cent of all non-oil manufacturing firms were in industries where four firms accounted for 40 per cent or more of all sales (Hill, 1996a, p. 167). Because Indonesian firms are usually part of conglomerates across industries, this understates the degree of seller concentration. And some of Indonesia's conglomerates, such as the Salim Group, are enormous. In 1992 its sales totalled 20,000 billion rupiah, accounting for nearly 20 per cent of sales of the largest hundred business groups in Indonesia (Sato, 1993, p. 409).

How has the government policy bias favouring a small number of large firms bound together in family-owned conglomerates affected the international competitiveness of Indonesian manufacturers? As experience elsewhere has shown, large business groups can help developing countries acquire industrial competence, internalize external economies, and overcome shortages of entrepreneurial talent,

¹⁸ During the first oil price shock, agriculture received 13 per cent of all development spending. Of this, between 4 and 30 per cent was for fertilizer subsidies alone (Gelb and Glassburner, 1988, p. 208).

¹⁹ Three aspects of this highly successful rice policy had positive impacts on the industrialization programme. First, self-sufficiency meant that scarce foreign exchange could be used to import capital and technology for industrialization, rather than to buy rice. Second, because of large swings in world rice prices, the thinness of world rice markets, and the large pull on prices exerted by Indonesia when it entered rice markets, large Indonesian imports of rice exerted a destabilizing influence on the macro economy. This undermined investment elsewhere in the economy, including in industry. Rice price stabilization helped overcome this problem. Third, stabilization of domestic rice prices around a declining world price of rice buoyed up profits, as this translated into a tendency for real wages to follow the price of the primary wage good, rice.

but they can also lead to substantial economic inefficiency.²⁰ What happened in Indonesia? Have any of these “infant industries” graduated into export production? If so, has export production involved the processing of primary commodities? While research in this area is sketchy, the experiences of two of Indonesia’s most influential entrepreneurs and their business groups appear to be typical (Sato, 1993, 1996).

Liem Sioe Liong, founder of the Salim Group, and William Soerjadjaja, founder of the Astra Group, began as merchants and importers/exporters. Liem provisioned the army during the struggle for independence (Sato, 1993, p. 411). After independence, he consolidated relationships with the military by becoming a reliable supplier of goods to the army to the then Lieutenant-Colonial Suharto in the Diponegoro Division in Central Java. Soerjadjaja got his start in the 1950s selling juice and daily goods and exporting primary products (Sato, 1996, p. 253). Both entrepreneurs benefited from close ties to political elites. The Salim Group’s early profits came from an import monopoly on cloves and preferential access to export quotas for coffee, rubber, cocoa and other primary products.²¹ The Astra Group’s early profits came from several sources including government contracts for importing asphalt (Robison, 1986, p. 277). Following Suharto’s rise to power, the Astra Group was asked by the Ministry of Industry to assist in the reconstruction of a State-owned auto assembly plant. Because of this, the Astra Group obtained lucrative sole (monopoly) agency licenses for importing and selling Toyotas and Daihatsus.

In both instances, group growth strategies were dependent on government policies and close links to political elites. When the government began promoting ISI, both groups benefited. During first-stage import substitution, the Salim Group got into cotton spinning and weaving, and flour milling; during second-stage import substitution, it diversified into cement and steel (Sato, 1993, pp. 414, 417-421). The Astra Group used its ties with government to consolidate its position in the automobile and machinery industry. This began with the acquisition of sole agencies for distributing imported vehicles and progressed during first-stage ISI to assembly; during second-stage ISI, the Astra Group moved heavily into component parts manufacture (Sato, 1996, pp. 254-257). Its shift from distribution to assembly and to the manufacture of component parts followed on the heels of government policy change. As Sato (1996, p. 257) states: “This fact reflects the Astra Group’s strict adherence to the government’s localization policies ...”.

²⁰ On the role of business groups in overcoming shortages in entrepreneurial talent and market imperfections, see Leff (1979). On how business groups can be used to acquire and disseminate industrial competence, see Mardon (1990).

²¹ The former provided revenues of around \$4.2 million per year between 1971 and 1980 (Sato, 1993, p. 411).

As government policy shifted in the 1980s to promote exports, both groups responded. Astra began exporting batteries and spark plugs, Toyota engines and Komatsu forklift frames (Sato, 1996, p. 260). It depended on its joint partnerships with Japanese multinationals to do this. And it expanded entry into manufactured exports by developing relationships with different multinationals; this included television set assembly and export with the LG Group of the Republic of Korea, and semi-conductor manufacture and export with a Singaporean company (Sato, 1996, p. 261). It also began investing in agro-business and estate cultivation of cassava and palm oil (Sato, 1993, p. 296).

The Salim Group's response to the new export incentive system was even more impressive. The Group reduced investments in cement, liquidated investments in steel, and moved into export manufacture (sport shoes, toys, garments and leather goods), and export-oriented agro-business (pig and shrimp farming, fish and poultry farming, orchards, fresh fruit and vegetable cultivation, and oil palm and sugarcane plantations) (Sato, 1993, p. 423). The Salim Group also moved overseas, where it invested in chemical production (Australia, the former Federal Republic of Germany, the Philippines, Singapore, the former Soviet Union and Viet Nam), and in the distribution and sale of consumer goods. By 1991 one of Salim's overseas ventures, the First Pacific Group, headquartered in Hong Kong, was selling 55 per cent of its output in Europe and the United States (Sato, 1993, p. 426). These new industries in the Salim Group are notably distinct from past investments. Most importantly, they revolve around vertical integration from raw material production through processing to final product distribution and sales.²² Because of this, "the Salim Group is in the process of transforming itself from being Indonesia's largest conglomerate to being a conglomerate that is making Indonesia the largest base of raw material production and processing, and whose business operations are now taking place across the broad expanses of Asia" (Sato, 1996, p. 427).

Is there any evidence that these developments were facilitated by selective (micro) interventions? Again, evidence in this area is sketchy, but there is some to suggest that selective interventions mattered. This is particularly true of developments in the auto industry that affected the Astra Group. Government auto policy was driven by two sectoral agencies, the Ministry of Trade and the Directorate of Basic Industries in the Department of Industry (Doner, 1991, p. 129). Because of resentment towards the multinationals that dominated this industry, the government announced policies as early as 1969 requiring localization and rationalization of the industry. Following anti-Japanese riots in 1974, localization and rationalization focused on working closely with what were to become large scale, integrated Indonesian

²² For example, the Salim Group not only raised chickens, it transported, butchered, processed, prepared and sold them (in, among other places, Kentucky Fried Chicken franchises that it owned around the world) (Sato, 1996, p. 425).

Chinese producers and distributors. One manifestation of this was creation of an effective public-private auto sector policy network composed of major domestic Chinese firms and individuals in the Directorate of Basic Industries (Doner, 1991, p. 132). The government enticed these firms to participate in this emerging public-private sector partnership by channelling to them government orders for vehicles.

Despite significant opposition by smaller *pribumi* firms to the government's localization and rationalization programme, there is substantial evidence that this strategy of public/private sector cooperation with large Chinese firms paid off. For one, large firms such as the Astra Group used the government's announced localization policy to press their multinational partners to localize production. Even though Astra's multinational partner, Toyota, was opposed to the localization programme, it assisted Astra in expanding in-house production of component parts. This included brakes, clutches, transmissions, leaf springs, wheel rims, transmissions, axles and steering gears (Doner, 1991, p. 147). Others were involved in the production of shock absorbers, radiators, mufflers, safety glass, seat frames, fuel tanks, cabins, frame assemblies, spark plugs, batteries, paint and exhaust systems (Doner, 1991, p. 143). This, along with the government's rationalization policy, which encouraged development of a smaller number of vertically integrated firms, helped the Sino-Indonesian automobile industry, including Astra, to become both stronger and more oligopolistic.

There is even some evidence that the macro technocrats participated in this strengthening of the local auto industry. Because of the ability to reap economies of scale, the government's rationalization and localization policies focused on commercial vehicles. Officials in the Ministry of Finance, who controlled tariff policy, calibrated tariffs to favour commercial vehicle sales. This was done by eliminating taxes on commercial vehicles and increasing them on automobiles. The purpose of this was to encourage a commercial vehicle to private vehicle sales ratio of 80 per cent commercial to 20 per cent private; this ratio was achieved by 1977 (Doner, 1991, p. 133). The technocrats' willingness to facilitate the development of backward linkages in the auto industry reflected agreement with the engineers in the micro agencies that Indonesia should not develop along the lines of static comparative advantage, as suggested by neo-classical economics (Doner, 1991, p. 149).

There is also some evidence to suggest that major automobile producers, such as the Astra Group, responded to the government's liberalization and export-oriented industrialization programme in the 1980s to increase technological capacity and to export. As Doner states, Astra recognized that liberalization imposed heavy costs on it (Doner, 1991, p. 153). Despite this, Astra complied with it because it feared that failure to do so could entail a total loss of State protection. This forced the Astra Group to accept the need to reduce costs and increase its technical capacity; it responded to this challenge by creating a

Technology Development Division committed to reducing costs. The Division developed several strategies for reducing costs: one focused on reducing excess capacity and eliminating duplication; another gathered comparative price data from elsewhere in South-East Asia and used it to negotiate lower prices with multinational capital goods suppliers, develop alternative suppliers of capital equipment, and depackage technology imports (Doner, 1991, p. 156). These strategies appear to have paid off as Astra began exporting in the 1980s. As mentioned earlier, this included exports of batteries and spark plugs, Toyota engines and Komatsu forklift frames.

But these are not the only examples of effective selective intervention. Other examples – the development of resource-based industries, particularly plywood manufacturing and liquefied natural gas (LNG), and aircraft manufacture – also deserve mention.

The Indonesian government banned log exports from the mid-1980s in order to support the nascent plywood industry. By 1992 APKINDO, the association of Indonesian plywood manufacturers controlled by Suharto's confidant Bob Hassan, had succeeded in raising the quality of Indonesian plywood exports sufficiently in order to get into the heavily protected Japanese plywood market. Despite this achievement, there have been two major criticisms against interventions by the Indonesian government in this regard. First, the ban on exports forced loggers to accept lower prices for their logs from the plywood manufacturers; this represented a welfare loss for the loggers, ostensibly in favour of the plywood manufacturers. However, the latter's inefficiency meant a corresponding welfare loss for Indonesia, involving an instance of value-enhancing but welfare-reducing rent-seeking. Second, Bob Hassan's self-serving control of APKINDO is also said to have caused the monopolist to become moribund, inhibiting the rapid development of industrial and marketing capabilities to ensure greater value enhancement with minimal welfare loss through the development of a more dynamic and efficient plywood-manufacturing industry in Indonesia.

The promotion of LNG followed on the heels of the government's expectation that windfall oil revenues could be used to accelerate the rate of growth of the non-oil economy. Because Indonesia's supply of oil was limited and dwindling, government efforts focused, on among other industries, the development and export of LNG. The development of this industry was based on negotiating long-term production and revenue sharing contracts with multinational producers, and equally long-run sales contracts with buyers, primarily in Japan (Auty, 1990, pp. 168-170). To this end, the Indonesian government invested billions through Pertamina, the State-owned oil company, in LNG production (Auty, 1990, p. 171). Little is known about the acquisition of technical competence by Indonesians in this industry; but, based on performance to date, these investments have been little short of astonishing. LNG

plants have run somewhere between 120 per cent and 145 per cent of capacity and earned healthy profits (Auty, 1990, p. 170). And LNG exports rose from virtually nothing in 1978 to over \$4 billion in 1993 (table 6). Because of this, it appears that Indonesia's resource-based industries, particularly in LNG, were low risk and relatively efficient (Auty, 1990, p. 213).²³

What has all this activity added up to? Is there any macroeconomic evidence to suggest that it has altered the composition of output or industrial structure? What has happened to overall productivity in industry? How has this activity affected the composition of exports? Evidence on each of these suggests that micro policies have made a difference. Before (1972) and after the 1981 oil price increases, comparisons of the composition of output relative to international norms suggest that selective policies hastened shifts in the composition of output. By 1981 the share of output in manufacturing was 36 per cent larger and the share of output in agriculture was 10 per cent less than international norms would suggest for a country of Indonesia's size and income (Auty, 1990, p. 206).²⁴ Over this period, the manufacturing sector's share in GDP grew twice faster than the norm, while there was little change in overall economic growth.²⁵ Because of this, manufacturing more than doubled its contribution to overall economic growth, while agriculture's contribution to growth declined by nearly half (Hill, 1996a, p. 21). Because much of this investment was relatively efficient, labour productivity in manufacturing increased by 10 per cent per year (Hill, 1996a, p. 27). Labour productivity in Indonesian manufacturing also increased relative to labour productivity in manufacturing in the United States (Szirmai, 1994, p. 73). Rapid growth in the manufacturing sector was combined with an equally rapid shift in the composition of manufacturing output. As late as 1971, consumer goods constituted 81 per cent of manufacturing value added, while intermediate goods (13.1 per cent) and capital goods (6.1 per cent) contributed relatively little. By 1981 the consumer goods share in manufacturing value added had declined to 47.6 per cent, while the share in intermediate goods (35.5 per cent) and capital goods (16.9 per cent) increased threefold (Roepstorff, 1985, p. 37).

But the most dramatic transformation in the economy occurred in exports (table 6). In 1970, 93 per cent of Indonesia's exports consisted of unprocessed raw commodities, 5 per cent of processed

²³ The state-owned steel industry and state-owned fertilizer plants have fared less well (Auty, 1990, pp. 180 and 191).

²⁴ This is remarkable, given Indonesia's rich natural resource base. The pull of this resource base on the composition of output should, if anything, contribute to a lower than expected share for the manufacturing sector.

²⁵ The economy grew at 8.2 per cent per year between 1972 and 1981, compared to 8.5 per cent per year between 1967 and 1972 (Auty, 1990, p. 205).

commodities, and the rest of manufactures. By 1993 the share of raw commodities in exports declined to 31 per cent, processed commodities contributed 17 per cent and manufactures 51 per cent. Except for Thailand and Russia, where average incomes were three times Indonesia's, this made Indonesia the largest exporter of manufactures among lower middle-income countries (World Bank, 1996, pp. 216-217). Among processed commodities, the major change was in LNG. Liquefied natural gas exports were non-existent prior to 1977; by 1981 they constituted 15 per cent of total exports, and by 1986 they equalled 23 per cent of exports. Given Indonesia's natural resource riches, it is hard to see how these transformations would have occurred without substantial government efforts to promote growth of the non-resource-based economy.

To sum up, in 1965 Indonesia was one of the poorest countries in the developing world (Meier, 1970, p. 23). At the time, well-informed observers gave it little chance of overcoming poverty and underdevelopment (Higgins, 1968; Geertz, 1963; Myrdal, 1969). Yet some 30 years later Indonesia is widely heralded as one of East Asia's high performing economies (Hill, 1996a; World Bank, 1993; Campos and Root, 1996). Because of long-standing and extensive, even by developing country standards, dirigiste microeconomic policies – in agricultural markets, in credit markets, and in trade and industry – and equally long-standing corruption and rent-seeking, explaining this success has not been easy for neo-liberals. They have resorted to two tactics in doing so. Most frequently, they dismiss these microeconomic interventions and rent-seeking as irrelevant to the economy's good performance, while warning that continued *dirigisme* and corruption could bring an end to the shared growth miracle (Hill, 1996b; World Bank, 1989). Alternatively, they assert that Indonesia's high growth in the face of pervasive *dirigisme* and rent-seeking is a testimony of how consistent application of sensible macroeconomic policies can "... counterbalance the ill effects of dirigiste micro policies" (Gillis, 1984, p. 244). Since neither explanation is particularly convincing, the remaining inconsistencies leave room for (selective) industrial policy explanations of the Indonesian miracle.

CONCLUDING REMARKS

Economic diversification has been considered an important component of the national economic development effort in South-East Asia, at least since the 1950s. This has involved diversification in the range of primary commodities produced as well as industrialization, including the processing of raw materials. Such diversification initiatives have often involved going beyond considerations of static comparative advantage. International specialization determined by such static comparative advantage considerations developed without any government interference, even during the colonial era. Most colonial authorities did not insist on a division of labour unjustified by such considerations. Thus, for example, during the colonial period much raw material processing emerged under “natural protection” because of transport costs or physical characteristics. However, new productive capabilities in which the economy concerned already enjoyed comparative advantage could not develop in such circumstances. Only government intervention through industrial policy measures could create the necessary windows of opportunity for new capabilities to be developed, thus transforming an economy’s comparative advantage.

Although the colonial division of labour or specialization under imperial authority largely determined the composition of output and exports before independence in Indonesia and Malaysia, post-colonial governments deemed diversification necessary to reduce their dependence upon and vulnerability to external markets for their generally limited range of primary commodity exports. Hence, diversification involved either greater domestic or external/foreign orientation. Diversification could thus entail more diversified raw material production or more industrial production.

As the above table suggests, output diversification may involve various combinations. New production, especially for export, has often been encouraged by new discoveries (of minerals, deposits or crop suitability), market conditions (e.g. timber, petroleum), technologies (e.g. new logging or mining technologies) and lower transportation costs (e.g. airfreight of electronic components). Nevertheless, while diversification may well have been facilitated by such new circumstances, most diversification would not have taken place without relevant government initiatives and encouragement. For example, government-sponsored research and extension has usually been crucial for crop diversification, while government geological or mineral surveys and exploration has often led to new mining activity. Similarly, government subsidies, protection, incentives and other support have encouraged agricultural diversification, as well as both import-substituting and export-oriented industrialization.

South-East Asian NICs: different types of diversification

		Market orientation	
		Domestic	External
Nature of new output	Primary production	Food production, etc.	Cash crop or natural resource
	Manufacturing	ISI	EOI

Policy lessons

The diverse experiences of the second-generation or second-tier South-East Asian HPAEs include some instances of failure where government interventions have probably involved continuing net welfare losses in the long run, with little likelihood of the emergence of internationally competitive industries or firms. However, this paper has focused on how government initiatives to diversify national economies have led to virtuous outcomes involving eventual net welfare gains or other national developmental goals (e.g. greater food security).

Government-promoted new agricultural development enabled the Malaysian economy to be less vulnerable to the vicissitudes of external markets for the export pillars of the colonial economy, namely tin and rubber. By the 1980s Malaysia had become the world's largest producer of palm oil, cocoa and pepper, as it lost its leading positions in tin and then rubber. Also, by the 1980s export earnings from both petroleum and timber exceeded all other export items, including manufactures. The paper also shows that the government has captured more effectively resource rents from petroleum and natural gas, compared to timber.

Government intervention in Thailand supported the rice industry, but also stabilized rice prices at a low level, keeping wage costs low for the economy as a whole, generating a surplus for the government as well as private capital accumulation and investments, and encouraging crop diversification. The government encouraged and supported investments in industries, including agro-processing, which have

generally become internationally competitive quite quickly, perhaps because of the relatively modest levels of protection and a greater degree of private sector influence and consultation. Nevertheless, government interventions have ensured that manufacturing growth has been greatly in excess of the level to be expected without such encouragement.

At least some of the resource rents from petroleum and LNG captured by the Indonesian government has been deployed to promote rice agriculture. By the mid-1990s Indonesia had even become a net rice exporter, thus not only achieving rice self-sufficiency and greater food security, but also contributing to economic development more generally, as in the Thai economy, by keeping wage costs down and expanding the domestic market for import-substituting industrialization.

One important difference in East Asia has been the significant contribution of corporate or firm savings, mainly owing to (family) corporate control characteristics and various tax features encouraging reinvestment, rather than to disbursement of dividends and the high profitability of investments, as a result of government support, incentives, protection and regulation. The continued availability of such investment opportunities contributes to a virtuous cycle of accumulation and growth. However, unlike companies in North-East Asia (Japan, the Republic of Korea and Taiwan Province of China), South-East Asian firms' industrial, technological and marketing capabilities have not enabled them to produce for export on their own. Instead, South-East Asian manufactured exports have primarily come from subsidiaries or companies vertically linked to foreign transnationals that have relocated in the region to lower production costs or overcome import restrictions. Hence, foreign direct investment has been far more important in South-East Asia than in North-East Asia, where governments have been very selective to the point of being restrictive. Whereas much export-oriented manufacturing in North-East Asia developed from import-substituting industries, such firms in South-East Asia have been much less linked to the rest of the host economies, thus creating the impression of new manufacturing export enclaves, not unlike the primary producing export enclaves from the colonial era.

The banking system and other lending institutions have also been less supportive of manufacturing, especially for export. In recent years, the Bretton Woods institutions have successfully promoted the expansion of stock markets in the region. For example, by mid-1997 the total market capitalization of stocks listed in the Kuala Lumpur Stock Exchange was more than four times the annual national income. Yet, less than 30 per cent of financing of new investments came through the stock market, while only slightly more than 20 per cent came from bank-lending and almost half from the firms' own resources, underscoring the significance of corporate savings for corporate investments and growth (Chin and Jomo, 1996).

Given the colonial and subsequent experience with export-oriented primary-producing enclaves, perhaps South-East Asia's export-oriented industrialization strategy, besides those industries involving domestic primary products (i.e. resource-based industries), has also been primarily of an enclave nature. But South-East Asian governments have not just let static comparative advantage considerations and natural protection determine the nature of resource-based industrialization. They have gone well beyond that by actively developing new capabilities through various industrial policy initiatives.

They have provided an array of supportive policies and institutions to support such development. Many of the new institutions have successfully addressed collective action and information problems, e.g. in the areas of research and development, education, training and marketing. Some of the new institutions have involved civil society, which has ensured policy and institutional responsiveness as well as greater transparency and accountability, reducing the scope for abuse and waste. Although the regimes have often been quite authoritarian in style and method, they have also enjoyed considerable legitimacy by ensuring participation in shared growth, thus also enhancing the credibility of development initiatives, policy and institutions. For example, the export booms since the late 1980s have been associated with greater concessions to and consultation with investors in the real economy.

Through agricultural and rural development ministries and other agencies, the governments have successfully introduced and promoted new crops, new crop varieties (e.g. new rice varieties as part of the Green Revolution achieving rice self-sufficiency), new agricultural inputs (e.g. fertilizers, pesticides) and new techniques and practices which have enhanced productivity, yields and incomes. Government construction and provision of supporting infrastructure (e.g. irrigation, transport and communications infrastructure) as well as information (e.g. through agricultural extension, radio-broadcasted agricultural advice, weather information and export crop prices) have also been important. Strong research and extension services have been important in promoting the best agricultural practices. Adaptive research and development have been crucial for the successful promotion of the Green Revolution in rice farming, for example.

Intal (1997) has suggested that sub-Saharan Africa has lagged behind in terms of agricultural development since the 1960s owing to inadequacies in agricultural R&D and infrastructure, crop and agronomic considerations and macroeconomic conditions. He argues that higher temperate agricultural productivity has partly been caused by long, sustained and larger investments in agricultural R&D, which temperate LDCs (e.g. Chile, the Republic of Korea and Taiwan Province of China) have been better able to take advantage of. The tropical Green Revolution in rice farming since the 1960s has mainly benefited

irrigated farms in South-East and South Asia, while drier agricultural practices in Africa have generally been left out.

However, the Malaysian, Indonesian and Thai success with tree crop agriculture offers some hope. The Malaysian experience, in particular, suggests that significant investments in tree crop agricultural R&D (e.g. in rubber, oil palm and cocoa) as well as rural infrastructure have made possible productivity gains in tree crop agriculture as well. The geographic specificities of agriculture imply that for imported agricultural varieties and technologies to be successfully adopted, there is a great need for effective adaptive investments in R&D and extension. Unfortunately, in their desire to industrialize, some governments have neglected agriculture or, worse still, have subjected it to considerable negative policy bias.

Government-provided and regulated credit facilities have also been very important for encouraging productive investments in new agricultural production as well as manufacturing. Finance ministries and central banks have stipulated minimal lending requirements to banks and other lending institutions, e.g. for manufacturing, small businesses or agriculture. Financial institutions have been encouraged through incentives, credit guarantees and even subsidies to lend to small businesses or farmers to whom they might otherwise not do so. In some instances, the government has intervened directly (through government agencies) or indirectly (via ostensibly private and non-governmental institutions) to provide credit to “deserving” activities deprived of adequate credit facilities

In the area of trade policy, the governments have introduced various incentives to increase value addition to exports of traditional primary products, as well as disincentives to discourage primary product exports and encourage investments to increase value addition. Market-based incentives have allowed more flexible implementation besides ensuring greater market responsiveness. Through government-sponsored or organized trade fairs, export promotion missions and bilateral government-to-government as well as private-sector arrangements sponsored by governments, South-East Asian governments have created new markets. This has been important, particularly in the face of exports facing new trade restrictions in traditional markets as well as potential trade barriers in new markets.

Where the quality of government performance has been high, as in Singapore, direct government intervention has generally been very effective and successful. This has been reflected in the effects of specific government regulations and their implementation and enforcement, as well as by the impressive performance of State-owned enterprises in the island republic. Where the likelihood of “State failure” is higher, market forces as well as greater consultation with and accountability to civil society have served to discipline the State and to improve the quality and outcome of government interventions. However,

it is crucial to identify the sources and nature of State failures in determining whether market solutions are necessarily superior; the converse is also true. Other experiences, including those of South-East Asia, offer important insights into what has happened in particular conditions and, appraised correctly, can be useful guides in considering available options, but they should not be treated as inflexible determinants of what should be done in Africa or elsewhere.

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