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Planning and Protectionism in Asia

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Planning and Protectionism in Asia

Reed Irvine

An official of an Asian government recently summed up the rationale of planning in essentially these words, "General Motors succeeds because someone at the top plans, directs and controls operations. What is good for General Motors is good for a country."

Another former high official of a government very much involved in planning, a man who has had excellent opportunities to observe at close range the results of efforts to run a country in accord with this formula, takes quite a different position. "Planning," he says, "takes very little account of the needs of world markets or the production of other countries. Partly as a result of this...governments take too little account of natural conditions affecting production. They often construct industrial plants without having sufficient raw materials available for them and almost never pay attention to the world level of prices and production. They produce some products at several times the production cost in other countries. At the same time industries of above average potential productivity are neglected. Entire new industries are being developed even though world markets are surfeited with the items they will produce. The working people will have to pay for all this...."<sup>1/</sup>

Planning in Asia limited

Those are the views of Milovan Djilas, who is now languishing in a prison cell for having had the fortitude to publish them. He was describing planning in a communist state, but much of what he says is applicable to what we see going on in many non-communist countries in Asia. Although nearly every non-communist Asian country has committed to paper some type of development plan, none of them pretend to plan and control the economy as thoroughly as any communist state. Such planning as exists tends to be fragmentary, with the so-called plans often representing little more than statistical exercises portraying hoped for goals. Private enterprise remains the dominant factor in all of these economies, but there is a strong tendency to assume that economic progress must necessarily depend heavily upon government direction and action.

While the governments have generally recognized the impossibility of their attempting to draw up and execute detailed blueprints covering all phases of economic activity, they have not hesitated to chart the general course which they expect to follow in pursuit of economic development. They have in varying degrees employed the diverse instruments at

<sup>1/</sup> Djilas, Milovan, The New Class, Praeger, New York, 1957, p.121.

their disposal to prod the economy along the charted lines. Direct government investment financed by tax receipts or borrowings has been widely used. Tax and credit policies, subsidies, open and concealed, and licensing of private investment have also been important weapons in the hands of some of the governments. The most potent and widely used instrument of all has come to be commercial policy, especially exchange and import controls.

The connection between planning and exchange controls

There is no necessary connection between economic planning and the use of exchange controls. Since most of the Asian countries are members of the International Monetary Fund, they have subscribed to the principle that such controls are to be used only as emergency weapons to combat temporary balance-of-payments problems. Economic planning could presumably be carried out in a country quite innocent of protectionist practices. However, it would appear that in many countries of Asia the primary function of controls has come to be protection of economic activities which the governments have decided to encourage. This is not too surprising, for while economic planning can theoretically work without protection, it is normal for anyone embarking on new and risky projects to seek to be shielded from competition. The private entrepreneur is not always in a position to secure such protection, but where the project is one that the government has encouraged, perhaps by investing its own funds, there is a strong temptation for the government to resort to protective measures to insure its success. The evils which Djilas ascribes to planning are rooted in this tendency to try to insulate the plan from competitive market forces that would expose the mistakes of the planners.

Even where protection has not been the conscious intent of a government in its administration of exchange controls, the restrictions placed on imports for purely balance-of-payments reasons have tended to influence the pattern of economic activity within the country. Industries have developed to produce goods which could not be imported in the quantities desired because the authorities assigned them low priorities. While this type of development may not have been planned, it is undeniably a reflection of the philosophy of the authorities who venture to replace consumer choice with their own judgment as the determinant of the import pattern. In the end, when the industries so developed become established, they tend to regard a continuation of protection as an established right which cannot be taken from them. They may have enough influence to win acceptance of this claim, with the result that something that started as an unplanned, almost chance, development may gain a permanent place in the economy with no one ever having even considered the question of whether it benefits the country or constitutes a burden upon it.

The use of controls to economize on the use of foreign exchange has not only had a direct affect on the pattern of economic activity, but it has also exerted a strong influence on the thinking of the authorities responsible for economic planning in nearly all Asian countries. Saving foreign exchange has come to be the criterion most frequently used in these countries to decide if a given developmental project should be undertaken or encouraged by the government. It is true that the explanation is usually couched in terms of the "essentiality" of the project, but in the final analysis "essentiality" is usually found to be defined in terms of saving or earning foreign exchange. The link between planning and foreign exchange controls is therefore somewhat stronger than the mere desire for protection. Since the object of much of the planning is basically to save foreign exchange, it is only natural that the planners should be disposed to rely heavily upon exchange controls.

Basically there is no difference between what at first glance appears to be two different motives underlying the use of exchange controls, but there is a slight difference in the results. The balance-of-payments motive is to effect foreign exchange savings, usually by restricting imports considered nonessential. The developmental motive is to effect foreign exchange savings also, but the imports restricted are those considered essential. The result in either case is that local production of the restricted imports is stimulated, but in one case the justification is that the production of necessities is being encouraged while in the other it is the production of the so-called luxuries that is stimulated.

#### More than foreign exchange saving to be considered

Obviously something is wrong when a country justifies banning an import because it is considered a luxury and in doing so encourages its domestic production at a cost considerably above that of the import. It is no less questionable a practice to raise the cost of necessities to the consumers by switching from cheap imports to domestic production. While it is true that the direct foreign exchange cost of domestic production may be lower than the foreign exchange expenditure required to import the goods, this is not the only comparison that has to be made. If it were, Scotland would raise grapes, the U.S. would produce coffee, and the world would be headed for economic autarchy.

The task confronting anyone who essays to plan the course of economic development for a country is by no means this simple. What must be decided is not whether a direct foreign exchange saving can be obtained, but rather whether any proposed project represents the most productive employment possible for the real resources involved. Would the Philippines be better off, for example, if the resources now used to produce chemical

fertilizer were employed in fisheries, furniture making, the expansion of fruit cultivation, or in any of a hundred other ways? Could the capital and labor now used by the Japanese automobile industry be more profitably employed in producing machine tools, optical goods, or chemicals?

Since in most economies there are thousands of potential uses for the available human and material resources, the selection of the best investments is a fine art and one at which even private practitioners sometimes fail even though they are concerned with only a fraction of the investment which government planners presume to direct. It is but natural that the planners should also err, perhaps more frequently and almost inevitably on a grander scale. The more sophisticated defenders of planning who recognize both the fallacy of the foreign exchange saving argument and the impossibility of accurately selecting the most productive types of economic activity, will admit that over-all planning is a gamble, an act of faith. It is their view that countries that want to develop rapidly will have to pick their projects, protect them, and pray that someday they will develop into winners. This, they would have us believe, is what all the industrialized countries have done. Is not the protection of infant industries a respected economic doctrine?

Growth without planning and protection: Hong Kong

It is certainly firmly embedded, but there is evidence that the importance of protection in fathering industrial development has been greatly exaggerated. Industry can take root and flourish in the absence of protection from advanced foreign countries. Modern proof of this is to be found right on the doorstep of the Asian countries that are so wedded to the infant industries argument. It is the example of Hong Kong, which without an iota of protection or subsidy has experienced an amazing industrial growth in the past ten years. Once strictly a trading center, Hong Kong now produces within her own narrow borders about one-third of her total exports. Her textile products are now competing strongly with the goods of such awesomely experienced producers as the Japanese. This is in striking contrast to the experience of protectionist countries like the Philippines. Some say that the example of Hong Kong proves little -- that it is invalidated by the special circumstances prevailing there. What are these special circumstances?

Hong Kong has a good port and an energetic labor force, albeit one which until recent years had little training in industry. It also has a scarcity of land, so much so that a considerable part of the bay is being filled in to provide plant sites. It has an extremely tenuous water supply, being completely dependent on rainfall. Some summers the water is on only a few hours a day. It is physically in the most vulnerable position in Asia in case Red China should decide to make an aggressive move.

It has just as bad a climate as many of its neighbors, and it has far fewer natural resources than any of them. It has had a burdensome refugee problem that it has pretty well solved without outside help.

The natural advantages of Hong Kong are fewer and its disadvantages greater than any of its neighbors. However, the man-made advantages more than compensate. It has a stable, honest government, low taxes and greater freedom from controls and government interference with business than any country in Asia. The relative abundance of capital in Hong Kong is the result of these man-made advantages. It has flowed into Hong Kong in spite of all the natural handicaps, much of it coming from neighboring countries far better endowed by nature. In contrast to the arguments that controls are essential to rapid industrialization, a Chinese businessman who has played a leading role in the development of the Hong Kong textile industry has said that the absence of controls was one of the most important factors in the rapid growth of that industry. He is free to make his purchases in what he believes to be the best markets, whenever he likes. He doesn't have to pay anyone off, and what is most important, he doesn't have to waste his valuable time trying to get special favors, buttering up officials, and trying to find the loopholes. There are always loopholes. Contrast this with the businessman of some standing in another Asian country who thinks nothing of humbling himself before a minor clerk and cooling his heels for literally hours in order to speed up the processing of an import license.

#### The example of Japan

If the example of Hong Kong is not enough to convince anyone that industrial growth is possible without protection they might find the history of the Japanese textile industry instructive. Some may think that this is treading on dangerous ground, since the idea is widespread that all Japanese industry owes its development to government planning and assistance. This impression is the result of some western historians' exaggeration of the importance of the Government's role in stimulating economic development in Japan. The Government certainly did many useful things. It set up schools, model factories, brought in foreign technicians and arranged foreign loans. It also provided some subsidies to privately owned firms, probably on a modest scale. All of this was quite unusual in the laissez faire environment of 1868-1880, and it must have impressed early observers, but one sometimes gets the impression in reading later writers that the Government picked the nation up from savagery and flung it a century ahead into the industrial revolution.

A more balanced assessment of the role of government planning and enterprise in Japan's development might note that on the eve of the

Meiji Restoration which brought in the Government that is supposed to have sparked Japan's industrialization there were already 765 factories in Japan with 10 or more employees and that the number of factories established annually showed no marked acceleration until the 1880's. The Government began to sell out its factories in 1881 and disposed of most of them in a few years time.

The industrial era in Japan is dated by the Japanese from 1882, the year in which cotton spinning began to show big progress. The first modern cotton mill had been set up in Japan in 1862, not by the Government, but by the Lord of Satsuma as a private venture. One of the writers who has placed a lot of emphasis on the role of the Government concedes that the expansion of the "textile trades depended little either on direct assistance from the Government or on the national economic policy... Their rise was the natural consequence of the redistribution of productive resources that resulted from the impact of Western trade and technique on the old Japanese economy."<sup>1/</sup> In view of the overwhelming importance of the textile industry in Japan, one would have thought that this fact would have made a little deeper impression upon western students of Japanese economic growth. The expansion of cotton spindles from 77,000 in 1887 to 2.4 million in 1913 without government subsidy or protection is a development that should be emphasized, not buried.

#### Some consequences of planning and protection

All of this supports the premise that the theory underlying planning and protection in Asia is extremely shaky and that the assumption that either or both are essential to economic development is unfounded. Djilas, however, goes farther and says that planning has resulted in uneconomic development in Yugoslavia and will prove costly to the masses of the people. There is no lack of evidence of this in Asia.

Korea has so many examples of questionable industries that the real problem is to find those that can safely be labeled economic. There is the Chungju fertilizer plant. The best commentary on it is the argument of one Korean official that it would be necessary to get another fertilizer plant into operation as quickly as possible in order to average the costs of production and permit the fertilizer from the first plant to be sold at a price that would not be too outrageous. There is the government-owned steel company that in September 1957 closed down its recently completed Inchon works, having discovered that the market for ingot steel in Korea would

<sup>1/</sup> G. C. Allen, A Short Economic History of Modern Japan, p.71.

not justify continued operation. There is the Hung Ah Tire Company, which was built at a cost of over a half million dollars and was bankrupt within a year after the plant was opened. The original justification for the plant was that the difference between the cost of importing 110,000 tires and importing the raw materials needed to produce that number of tires was about \$1.2 million. Apparently no one was interested in the hwan cost of converting that raw material into a tire, and even today when efforts are being made to get the plant back in operation the cost apparently remains an unknown quantity. There is the glass bottle plant that went into operation for a few hours in August, 1957 to produce some samples and that hasn't operated since. The owners refused to stock the needed spare parts and some damage was incurred that they have been unable to repair.

The failures in Korea are in part the result of inadequate human material for the job that the Government is trying to do. But this is one of the "natural conditions that affects production." And so is the scarcity of operating capital. Because of the aid program the cost of the mistakes is being borne largely by the U.S., but the Korean people suffer too in the sense that the capital might have been used to benefit them had it been used more wisely.

### Japan

In Japan the Government has made strenuous efforts to rebuild the merchant marine, and very large amounts of capital have been channelled into shipping through government banks and the use of government influence on the private banks. The return on investment in this industry is the lowest in Japan and is far out of line with other types of enterprise. In the six months ending March 31, 1957, a period of prosperity for the shipping industry, the return on paid up capital in shipping was 7.23 per cent compared to an average of 63.7 per cent for manufacturing industries. The return on total capital employed in manufacturing was over four times as great as in shipping. No defense argument is made for the Japanese merchant marine, and on economic grounds it is apparent that the capital absorbed by this industry could have found more profitable employment. One Japanese manufacturer, who thinks that more capital should go into the modernization of manufacturing industry, has pointed out that it will do Japan little good to have a fine large merchant marine if necessary steps are not taken to keep her industrial products competitive in export markets.

### Philippines

The Philippines is heavily loaded with new industries of dubious economic value that have been encouraged by tax exemptions and protection

from imports. It is possible that some of these will prove to be economic, but in the Philippines higher rates of productivity can probably be obtained from agriculture and minerals exploitation which have a long record of successful competition in international markets than from most of the industries that have developed under hot-house conditions with no evidence of any ability to survive in free competition. There is good evidence that the Philippines has been seriously injured by an effort to develop industry of doubtful value at an unreasonable pace. The country is now experiencing a serious crisis which is largely the result of this. The effect on the economy and the standard of living has been disguised by drawing down foreign exchange reserves, but the temporary nature of this solution has now been fully revealed and severe import restrictions have been imposed that are both hurting living standards and threatening much of the shaky industrial growth.

#### The by-products of controls

If the results are so unfavorable how can these systems survive in free countries? Two reasons stand out. Corruption, waste and inefficiency are not the only products of the system. Freedom of speech has also suffered a setback. The businessman dependent on an import license to run his business is not inclined to expose publicly the venality of the administrators. Nor does he feel free to attack the system of controls and campaign for its abolition, no matter how great the advantages of such a step to the country may seem. There are examples of businessmen who tried this and came to grief. This is one reason why the more deeply entrenched, the more stifling, the system becomes the more difficult it becomes to eliminate it.

#### Aid and controls

In addition to this the burdens which the system has brought have in many cases been offset by large scale American aid, which has helped maintain or even improve living standards. It is ironic that one result of the aid given to strengthen the free countries of Asia has been to buttress the economic policies that constitute such a great barrier to real economic progress. This is a dilemma inherent in programs of this nature. To be sure, there have been efforts to use American aid to strengthen private enterprise, but close cooperation with the governments of the recipient countries is indispensable in programming the use of aid funds, where those governments have a predilection for planning and controls it is easier for those administering the aid to work within that framework than to attempt to alter it. Indeed, in some cases the aid administrators, like the governments, find it convenient to have projects which they have financed protected from the harsh winds of foreign competition.

The situation is potentially dangerous. Dissatisfaction with the existing state of affairs is increasing in Asian countries. Ironically the evil consequences of controls are too often interpreted as a sign of the failure of democracy and the free economic system. The remedy too often advocated is greater, not less, government interference with the economy. This could have surprisingly unpleasant consequences in the long run if not checked at an early date.

*M. Thorne*

Addendum to Planning and Protectionism in Asia by Reed J. Irvine

Since this paper was written evidence has come to hand that official cognizance is being taken of the errors in investment that have been induced by government action in Taiwan. Mr. K. T. Li, a member of the Industrial Development Commission of Taiwan, writing in the March-April 1958 issue of the Bank of China's Bi-Monthly Economic Review has this to say,

The development of certain industries has been specially encouraged by the Government, e.g., by making available raw materials and the necessary foreign exchange required for the procurement of machinery and by restricting imports of like products of foreign origin. Textile, flour, edible oil and soap, for instance, are among the industries that have received such special Government assistance and consequently have attracted considerable private investment capital. Unfortunately, the domestic market is too small for them and the manufacturers who have been accustomed to Government protection and are unable to meet competition in the world market are finding themselves in an increasingly difficult situation. New industries would have to be developed and established, or existing industries completely modernized so as to be in a position to engage in export. p. 3

A new direction in our industrial effort has become necessary if we are to achieve a sustained, healthy economy. That direction is toward the creation of large scale industries whose product is fully capable of meeting competition from foreign manufacturers and can be exported to the world market. p. 4

Of the many difficulties contributing to the failure of opening up an export market, there are two that are perhaps the most obvious: First, the greatest majority of our factories are not of optimum size and, therefore, do not lend themselves to efficient and economic operation. Second, their operations are not sufficiently integrated, so as to permit reduction of manufacturing costs. pp. 21 (my underlining)

It is unfortunate that these facts were not recognized before millions of dollars were invested in uneconomic plants. There is still no indication that the Nationalist Government will have the inclination or ability to rectify this situation by actually exposing the inefficient hot-house industry that has been developed to the cold winds of free competition, but perhaps it is not too late for others to profit from Taiwan's experience.