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Political Foundations for Sustainable Growth in Asia

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In the annals of economic development, many countries in Asia have achieved consistently superior economic performance in the last half century. Their record in poverty reduction, sound economic management, and export growth has surpassed that of most other developing countries. From the 1960s to the 1990s, Asia was home to some of the world's most dynamic and successful dragon economies, such as Hong Kong (China), the Republic of Korea, Singapore, and Taiwan (China).[1] Today, the two Asian giants, China and India, are reshaping the global economic order through rapid growth. At the current rates of growth, Asian economies will remain the world's most dynamic for the foreseeable future.

A major source of growth for Asia will continue to be the region's integration with the global economy. Indeed, few would dispute that Asia has been a primary beneficiary of the globalization of trade and investment. The region has gained share in global output, trade, and investment. The domestic economic momentum that has powered Asia's growth, such as the high savings rate and the migration of rural surplus labor into urban areas, remains healthy. Regional economic integration is also proceeding at a rapid pace, driven primarily by private sector activities in trade and investment and secondarily by emerging institutional arrangements such as regional free trade agreements (Krumm and Kharas 2004). The robustness of Asia's economic health is all the more remarkable considering the devastating effects of the East Asian financial crisis of the late 1990s. Indeed, few expected the region to rebound from the catastrophe so quickly and well (World Bank 2000).

Still, it would be naive to take Asia's growth for granted. Behind the region's increasing prosperity and impressive dynamism lurk dangers and risks that, if ignored and mismanaged, could slow Asia's ascendance (Stiglitz and Yusuf 2001). On the geopolitical front, Asia is home to three potential flash points: Kashmir, the Korean Peninsula, and the Taiwan Strait. Any miscalculation or crisis mismanagement could ignite a dangerous military confrontation with unimaginable consequences. But the most likely and most potent source of disruption is rising discontent with political leadership, lack of government integrity, and misguided public policies in most of Asia. In Thailand, public anger over Prime Minister Thaksin Shinawatra's questionable business deals fueled mass rallies that ultimately drove the Thai politician, a man with a reputation for strong leadership, from office in disgrace in 2006. Thaksin's Philippine counterparts have fared little better. Alleged corruption forced President Joseph Estrada from office in 2001. Recent allegations of corruption have politically crippled Gloria Macaraeg Macapagal-Arroyo, Estrada's successor. In Korea, Prime Minister Lee Hae Chan resigned under a cloud in March 2006 after it was discovered he had played golf with an indicted businessman and had engaged in gambling. Lee's boss, President Roh Moo-hyun, narrowly survived impeachment in 2004 after his repeated political missteps cut into his public support and allowed the opposition to exploit his ineffective leadership.[2] In Taiwan, the pro-independence president, Chen Shui-bian, has accomplished nothing during his six years in office except for constantly playing the divide between mainlanders and native-born Taiwanese and provoking Beijing with moves that might lead to formal independence for the island and to an all but certain military conflict with China. With the economy stagnating and public disappointment running high, President Chen narrowly won reelection in March 2004 under controversial circumstances. (He survived an attempted assassination on the eve of the election, but the government later claimed that the chief suspect had committed suicide.) Hong Kong, East Asia’s financial and services hub, which returned to Chinese rule in July 1997, has had its share of economic and political turmoil. Shaken by a succession of financial shocks and public health crises, the residents of the former British colony have grown dissatisfied with the performance of their postcolonial government. In July 2004, more than 1 million Hong Kong citizens took to the streets to demonstrate against a proposed security law that night have threatened their civil liberties. Responding to mass discontent, the central government of China was eventually forced to ask Hong Kong’s chief executive, C. H. Tung, to retire two years ahead of schedule.

Unquestionably Asia’s star economic performer since the late 1970s, China is also encountering rising skepticism about the sustainability and correctness of its leadership’s pro-growth strategy. Including rising income inequality, rampant official corruption, deteriorating social services, and large-scale environmental degradation, the social costs of China’s economic rise have become more visible and more politically unsustainable (Pei 2006a).

The biggest political surprise in Asia occurred in India in May 2004. By all accounts, the coalition government led by the Bharatiya Janata Party had delivered robust economic performance and had implemented effective market-oriented reforms. Yet, a slight majority of the Indian electorate appeared to believe that the fruits of these reforms had been unevenly distributed. Exercising their democratic right, India’s voters replaced the Bharatiya Janata Party with the Congress Party, which had promised to give more attention to those left behind by India’s impressive economic progress.

Why is a region that is doing well by many conventional economic indicators experiencing rising public discontent about government? Will the discontent precipitate instability and slow economic progress in the region? How should Asia’s governments respond to a public that is increasingly assertive and often unforgiving?

I argue that governments in Asia must not allow strong economic fundamentals to obscure the political risks inherent in experiencing rapid economic modernization. Indeed, any sustained economic progress must be based on solid political foundations that are constantly rebuilt and strengthened. In the 1960s and 1970s, national experiences unique to the region helped build the political coalitions and institutions that were later credited with making superior economic performance possible (Rowen 1998). These political coalitions have frayed in recent years. Political institutions that were once so suitable for mobilizing resources for rapid growth are adapting poorly to an era in which government integrity and social equity are assuming political importance. China’s enormous success in the past three decades and the daunting challenges ahead illustrate this argument. The Chinese example encapsulates the Asian experience of balancing many critical developmental objectives in the course of rapid modernization. Whether and how China maintains its forward momentum and manages these challenges are not only important to the welfare of its 1.3 billion people, but also critical to the peace and prosperity of the entire Asian region.

Why sustained economic growth requires solid political foundations

Although the idea that any society aspiring to achieve superior and sustained economic growth needs solid political foundations may sound self-evident, only a small number of countries have managed to build and maintain such foundations. Although definitions of what constitute sound political foundations may differ, the experience of the most successful East

Asian economies suggests that political systems with the following characteristics and capabilities are more likely to achieve sustained rapid economic growth and maintain social peace:

- A broadbased societal consensus on the desirability of market-oriented reforms
- An encompassing political coalition that rallies support from various segments of society behind reform-minded leaders
- Strong technocratic capabilities for macroeconomic management, the means for resource mobilization, and effective institutional mechanisms to control corruption
- Public policies designed to mitigate the undesirable effects of rapid economic growth, especially income inequality
- A system for the rule of law that protects property rights, enforces contracts, and enhances the predictability of the policy environment

It is worth noting that not every successful East Asian society has enjoyed all of the pro-growth political conditions in equal measure. The political foundations have been stronger in some countries than in others. And, within individual countries, some constituent parts of the foundations have been sturdier than others. Although no systematic research has been undertaken to demonstrate the link between the strength of these political foundations in a society and the sustained economic performance of that same society, political economic theory would suggest that this link not only exists, but is most likely positive.

That there is a relationship between strong political foundations and sustained, superior economic performance is intuitive. But less well understood is how such foundations were first built and whether, once built, they can be maintained. Based on the experience of the first-generation tiger economies, as well as nearly all other high-performing Asian economies, two commonalities stand out: crisis and leadership. Political and economic crises have precipitated radical policy changes in most Asian countries for several reasons. Typically, severe political and economic shocks discredit and delegitimize preexisting policies because these policies are believed to have caused political and economic catastrophes. At the ideological level, crisis paves the way so that new ideas and values may gain dominance and influence development policies. Crises frequently lead to the exit from power of the old ruling elites responsible for the failings of the government. These old elites are replaced by new elites eager to reestablish political legitimacy by delivering better performance. Crises also provide the new elites with a fresh political mandate, which, in turn, creates more room for undertaking high-risk, but potentially high-return reforms that would be politically impossible under the old regime.

Yet, profound political and economic crises alone do not always create the political openings for radical policy shifts. Only countries blessed with the appropriate political leadership can seize the opportunities generated by such crises to break decisively with the past. Table 14.1, which briefly summarizes the turning points in Asia's most successful economies, shows that the combination of crisis, leadership, and policy response has paved the way for the initial economic take-off in the region over the past half century. Furthermore, the direct result of the policy response to the crises in these countries was revived economic growth, but also a significant strengthening of the political foundations for economic development. In nearly all the countries that made a decisive break with their failed pasts, leaders were able to articulate a clear vision for a different future. An encompassing societal consensus on market-driven growth was achieved, largely thanks to the proven failures of the old economic strategies and policies. To varying degrees, radical leftist or statist ideologies were abandoned completely. A broadbased governing coalition, including political elites, technocrats, the military, the intelligentsia, and private entrepreneurs, has minimized conflicts among key interest groups and has focused energies on top developmental priorities. In many countries, the ruling elites wisely adopted public policies, such as the expansion of access to education and health care, that contributed to poverty reduction and social equity, thus strengthening the political legitimacy of pro-growth strategies.

TABLE 14.1. The Leadership Response to Crisis in Selected Asian Countries

Economy	*Crisis*	*Leadership*	*Postcrisis response*
Taiwan, China	defeat in war; popular revolt on Taiwan (1947–49)	Chiang Kai-shek and Chiang Ching-kuo	land reform, privatization, local elections, equitable growth policies, export-led development strategy (1950s and 1960s)
Korea, Rep. of	political gridlock, loss of public confidence, illegitimate election, rampant corruption (1950s)	Park Chung Hee	restoration of macroeconomic stability, land reform, investment in education, government-directed credit to key industries, capable civil service (1960s and 1970s)
Singapore	breakup with Malaya (1965)	Lee Kuan Yew	institution of the rule of law, investment in education, competent civil service, clean government
Malaysia	ethnic riots (1968)	United Malays National Organization, coalition	policies favoring Malays, encouragement for foreign direct investment and export-led growth
Indonesia	failed coup and collapse of the old regime (1965)	Suharto	restoration of macroeconomic stability, use of technocrats and international expertise, encouragement for foreign direct investment
China	Cultural Revolution (1966–76)	Deng Xiaoping	decollectivization of agriculture, economic liberalization, opening to the West, and ending mass political terror
Vietnam	economic stagnation and invasion of Cambodia (1979–86)	Communist Party of Vietnam, collective	agricultural reform, withdrawal from Cambodia, opening to the West, encouragement for foreign direct investment
India	balance of payments crisis (1991)	Prime Minister Narasimha Rao and Finance Minister Manmohan Singh of the Congress Party	radical economic liberalization, deregulation, integration with the global economy

Source: Compiled by the author.

However, the political foundations that were carefully constructed following these reform-initiating crises must be reinforced constantly. In particular, the two institutional pillars for maintaining growth momentum and broad political support—the rule of law and political mechanisms for government accountability and integrity—must be continuously strengthened to constrain the state, already relatively strong in most Asian countries, from dominating market forces or becoming predatory. In retrospect, building the rule of law and maintaining government accountability and integrity were the two tasks that even the most successful East Asian societies failed to perform entirely. Rapid economic growth quickly lifted standards of living, but, except in Hong Kong and Singapore, failed to produce legal, regulatory, and political institutions effectively to protect property rights, limit state power, and curb political corruption. In the 1990s, unconstrained by such institutions, most societies in East Asia fell victim to crony-capitalism (incestuous ties between the political elites and the economic elites), with disastrous economic, social, and political consequences. The 1997–98 East Asian financial crisis was, in large part, caused by the region's weak institutional capacity in financial market regulation, corporate governance, and guaranteeing government integrity. In this regard, the lesson of Indonesia is the most tragic and the most instructive. For three decades, Indonesia achieved world-beating developmental success, albeit under authoritarian rule. But the pace of institution-building, especially in vital areas such as the rule of law, political accountability, and democracy, lagged far behind economic growth. As a result, the authoritarian regime, centered on President Suharto's family and its network of crony-capitalists, grew increasingly venal and neglected the public's need for equity and social justice. At the same time, the Indonesian state's capacity to regulate its financial system remained woefully inadequate, allowing insider dealing and related party lending to go out of control. Politically, the public grew disenchanted with an authoritarian regime that was seen as incurably rapacious and corrupt, despite the three decades of unmatched economic prosperity. Thus, when the East Asian financial crisis hit in 1997–98, Indonesia had neither the financial strength nor the political foundations to weather the storm. The authoritarian regime, along with the country's rickety banking system, collapsed in spectacular fashion. Practically overnight, an erstwhile success story became a poignant negative lesson.

Regrettably, unlike the political and nationalist upheavals in the 1960s and 1970s that later ushered in system-transforming reforms, the East Asian financial crisis did not produce similar long-lasting changes (except in Korea and Singapore).[3] One reason might be the relatively short duration of the crisis and the mildness of the suffering (except in Indonesia). Another and more important explanation is that, except in Korea and Singapore, political leaders failed to seize the opportunities created by the crisis to initiate reforms and strengthen the political foundations for sustained growth. A few badly needed technical reforms were undertaken, such as enhancing the supervision of the banking sector, instituting minor corporate governance reforms, and maintaining significant foreign currency reserves to prevent another financial crisis. However, countries generally did not attempt to introduce policies that would make governments more accountable or make the process of growth more inclusive and socially equitable.

Weak political foundations do not necessarily affect short-term economic performance. Indeed, the strong recovery in Asia following the crisis both masked the weakness of these foundations and reduced the pressures for reform. Fragile political foundations reduce the political support available to sustain rapid growth, and this allows social and economic dislocations. When large segments of the population perceive that the benefits of rapid growth are being unjustly distributed, they question the legitimacy of the government's pro-growth policies and may take political action to contest them. Policy responses to rising public discontent against perceived social injustice and government insensitivity should include short- and long-term strategies. A long-term strategy must be centered on building the institutions that will make the political process more inclusive, the government's commitments to good governance more enforceable, and the fruits of economic growth more equitably distributed. The short-term strategy should use the tools of public policy, such as taxation, health care, and education, to provide relief to social groups that have benefited relatively much less from rapid growth. If implemented well, these policy responses will bolster the political support for sustained reform and development.

Rebuilding political foundations for growth: the case of China

Few major economies have achieved as stellar a record of rapid growth as China in the past three decades. Since the onset of economic reform in 1979, China has maintained an annual growth rate of 9.2 percent and lifted more than 200 million people out of abject poverty. Its per capita income rose from roughly US$150 in 1978 to about US$1,700 in 2005. China has also become deeply and extensively integrated with the global economy. Its foreign trade skyrocketed from US$20 billion in 1978 to more than US$1 trillion in 2005, elevating China to the world's third largest trading nation. In the same period, investor-friendly policies and China's comparative advantage as a low-cost manufacturing site attracted over US$600 billion in foreign direct investment and turned the Chinese economy into a pivotal link in the global supply chain. Economic success has transformed Chinese society and greatly improved the quality of life of the average person. Today, roughly 45 percent of the population lives and works in urban areas, compared with about 20 percent in the late 1970s. Physical mobility and access to information have grown equally rapidly. Economic liberalization has enabled millions of Chinese entrepreneurs to establish their own businesses and acquire private wealth undreamed of under orthodox communist rule. The result is an extremely dynamic society.

Yet, China's economic success has incurred real and significant social costs, which are weakening public support for market-oriented reforms. Ironically, while the West was becoming increasingly alarmed at the impact of China's rapid growth, China itself was beginning to worry about the direction and sustainability of this path. This paradox is most evident in the recent, contentious policy debate among China's political elites over the causes of many socioeconomic problems, especially rising income inequality, the lack of affordable education, the poor access to health care, and runaway corruption.

The facts appear to back up the arguments of many critics of China's single-minded pro-growth strategy of the last three decades. There was the impressive achievement of poverty reduction, the rising standards of living, the social modernization, and the integration with the world economy, but there, alongside, were also significant and worsening social deficits.

Rising income inequality

Admittedly, China was an unusually, if not excessively, egalitarian society under the radical rule of Mao Zedong. But the level of income inequality has risen significantly during the reform era, particularly since the 1990s. Various estimates put the range of the Gini coefficient in China today at between 0.42 and 0.48, implying a 50 percent increase in the level of income inequality since the beginning of economic reform.[4] Of course, the most important factor in the increase in income inequality is expanding rural-urban income disparity. The disparity was narrowing in the 1980s thanks to agricultural reform, but has since risen to the highest level in the history of the country.[5] It is widely recognized that the causes of rising income inequality are numerous and complex. This is also a global phenomenon (although the rate of increase varies from country to country). What appears to make rising income inequality politically sensitive and potentially polarizing is the combination of two issues: corruption and the declining provision of public goods.

Corruption

The abuse of power by government officials for personal gain exacts real economic costs, but also directly worsens socioeconomic inequality. Corruption allows politically powerful or connected individuals to gain unfair economic advantage. In a transition economy, such an advantage may easily be turned into enormous private wealth. State-owned properties, such as land and industrial assets, are being sold off to private investors, usually through an opaque process and at prices far below fair market value. Additionally, the decentralization of power, necessary so as to provide local officials with greater incentives and more autonomy to improve their economic performance, also creates opportunities for corruption. Despite a lack of good data on the extent of corruption in China since the late 1970s, several indicators suggest that the scourge of corruption is serious and spreading. The number of legal and judicial cases involving large sums of money has risen significantly since the 1980s, as has the number of senior government officials implicated in corruption scandals. Published official data indicate that the enforcement of anticorruption measures has fallen off in recent years.[6] Corruption has assumed more insidious characteristics as well. It is now being perpetrated by collusive local officials. The practice of accepting bribes in exchange for giving bribers powerful positions in the government has become widespread. Most worrisome, corruption has hit some of China's most crucial industries, such as financial services, transportation, and construction. Corruption has emerged as one of the principal causes of public discontent.

The declining provision of public goods

To be fair, China's performance in providing health care and education to its people compares favorably with the performance of countries at similar levels of economic development, as shown by China's relatively high scores on the Human Development Index (UNDP 2005). However, the Chinese government has significantly reduced its contribution to health care and education expenditures in the last two decades. According to Chinese official data, government spending on education fell about 20 percent as a share of total education expenditures in the 1990s. The central government contributes only 1 percent to the entire rural education system. Public spending on health care fell even more steeply. In the 1980s, public spending accounted for 36 percent of all health care costs; in 2000, the share fell to less than 15 percent.[7] As a result, individual citizens have begun to bear greater financial risks and responsibilities for their access to health care and education. Many have been priced out of the market. Government data show that about two-thirds of Chinese citizens lack any form of health insurance, and more than half forgo medical care when they get sick. Besides health care costs, educational outlays, including school fees for primary education and college tuition, have become unaffordable relative to incomes. Declining access to health care and educational opportunities increases inequality directly because it particularly hurts the poor and underprivileged and creates a vicious cycle of poverty and shortages of human capital.

Fortunately, the Chinese government, especially under the new leadership, has become aware of the rising social deficits and begun to respond to public pressure to reorient China's development. President Hu Jintao and Premier Wen Jiabao have publicly pledged to pursue a people-based development strategy and place less emphasis on growth rates. Reacting to rising incidents of social unrest, the new leadership has called for a more responsive government and for social harmony and has launched a series of initiatives to address the social deficits accumulated during the 1990s. The government has abolished a regressive agricultural tax and raised spending on health care and education in rural areas. By and large, these policy responses have constituted the initial steps toward building fresh political foundations for sustained growth. They are guided by a new vision (people-based development and social harmony) and backed up by specific policies aimed at spreading the fruits of China's rapid growth to underdeveloped rural areas. China's new leaders face daunting challenges in balancing the imperatives of high growth and the pressures of social frustration and public disenchantment with socioeconomic inequality and injustice. They also have enormous assets at their disposal, such as three decades of experience in managing a transition economy, growing fiscal resources, achieving strong performance in exports and the balance of payments, boosting entrepreneurial private firms, and welding deep and extensive links with the global economy. To increase the odds of success, Beijing needs to take additional, more aggressive steps to mitigate socioeconomic inequality and reduce the stockpile of social deficits. Chinese leaders need to understand that credible public policy commitments must be backed up by political and institutional arrangements that function as enforcement mechanisms. Policy initiatives aimed at benefiting the poor and the disadvantaged would be more credible if the beneficiaries were incorporated into the political process or their representatives influenced policy. Similarly, pledges to improve governance and combat corruption will gain credibility if they are accompanied by specific measures to strengthen judicial independence and empower civil society.

Conclusion

The experience of Asia's successful economic development in general and China's in particular confirms that the political support for economic reform and growth must, like the social contract, be renewed constantly. No government can expect to derive permanent legitimacy from economic performance that occurred in the past, however impressive that may have been. In the six decades since the end of World War II, visionary leaders in many Asian countries have been able to turn crises into opportunities and build the political coalitions needed to take their economic development in new directions. Their legacies have created favorable economic conditions for their successors to continue the journey to peach and prosperity. But the generation of visionary leaders, themselves a product of unique historical circumstances (war and revolutions), is gone, and Asia's new leaders must find fresh visions to inspire their societies and reenergize their peoples. They may have a better chance of success if their new social contract is based on three broad principles:

- Socioeconomic equity: Public policies, especially those on health care and education, must be designed to mitigate the negative effects of rapid growth. Without such policies, no societal consensus will be sustainable.
- Compensation for losers: In today's environment of the hypercompetitive global marketplace, rapid technological change, and short-lived comparative advantage, governments must develop political mechanisms to compensate losers. Specifically, socially disadvantaged groups must have opportunities to organize and gain access to political power. Only political arrangements that empower such groups will credibly defend the interests of the disadvantaged. On balance, the benefits of compensating the losers, most likely reflected in greater social stability, will outweigh the costs (higher social spending).
- Good governance: Increasing governing capabilities and maintaining the integrity of the government will confer enormous competitive advantages, but also help strengthen societal cohesion and political legitimacy. Policies and political mechanisms designed to fight official corruption are therefore of paramount importance because no governments can expect to maintain public support if their officials engage in corrupt activities with impunity.

To be sure, these principles are well known and self-evident. But it is remarkable that so few governments and leaders in developing countries have been able to articulate these principles in coherent policy platforms or incorporate them into effective public policies. In the age of information revolution and globalization, leaders in Asia today have no choice but to try to prove the cynics and pessimists wrong. The alternative vision—social disharmony, economic stagnation, and political strife—is not the one any self-respecting leader in Asia should entertain.

Notes

[1] The most influential work is World Bank (1993).
[2] The impeachment was overturned by the country's Supreme Court.
[3] One may also argue that China took advantage of the crisis to force mass layoffs and bankruptcies among state-owned enterprises.
[4] The Gini coefficient at the end of the 1970s has been estimated at about 0.28.
[5] The urban-rural income ratio is 3 to 1 today, although, if various hidden urban subsidies are included, the real ratio becomes much higher.
[6] As measured by the percentage of officials prosecuted in the courts. See Sun (2004).
[7] The figures are cited in Pei (2006b).

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