

**ASIAN ECONOMIC SUCCESS AND LATIN AMERICAN  
FAILURE IN THE 1980S:  
NEW ANALYSES AND FUTURE POLICY IMPLICATIONS**

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## **ABSTRACT**

A striking feature of the world economy during the last decade has been the collapse of economic growth in Latin America whilst industrialization and development have proceeded apace in the Asian countries. This paper first assesses alternative explanations of the Asian economic success and the Latin American failure during the 1980s. Secondly, it examines the related question of the long-term development strategies followed by the outstandingly successful East Asian economies. The paper arrives at rather different analyses and policy conclusions on these issues from those of the international financial institutions and the mainstream economists.

## **RESUMEN**

Un rasgo notable de la economía mundial durante la última década ha sido el colapso del crecimiento económico en Latinoamérica, mientras que la industrialización y el desarrollo han avanzado rápidamente en los países asiáticos. Este trabajo evalúa, en primer lugar, las explicaciones alternativas del éxito asiático en materia económica y del fracaso latinoamericano durante la década de los ochenta. En segundo lugar, analiza el tema, vinculado al anterior, de las estrategias de desarrollo a largo plazo seguidas por las notablemente exitosas economías del Asia oriental. El análisis y las conclusiones de política económica que, sobre estos temas, desarrolla el trabajo, resultan distintos de aquéllos presentados por las instituciones financieras internacionales y los economistas ortodoxos.



## Section I Introduction

The three decades from 1950 to 1980 were in an important sense the 'Golden Age' of development for the poor countries of the world. During this period, developing countries on the whole made historically unprecedented economic and industrial progress. In the propitious circumstances following the end of the Second World War, many of these countries, particularly in Asia and Latin America, began to carry out an industrial revolution—a revolution that they had been prevented from implementing fifty or a hundred years earlier on account of the rather different world economic and political conditions that prevailed then. Significantly, a group of Asian and Latin American nations—the so called NICs (Newly Industrializing Countries)—were especially successful in the post-World War II period in establishing technical, scientific, and industrial infrastructures, in training their labor forces, in creating managerial and organizational capacities, and in developing broad-based industrial structures. By the 1970s these countries were providing formidable competition to the rich industrial economies in a range of consumer and producer goods industries (Singh 1984).

However, a striking feature of the world economy during the last decade has been the interruption (and, indeed, in many cases reversal) of this process in Latin America, whilst the industrial revolution has proceeded apace in the Asian countries. In a period of slow and fluctuating world economic growth in the 1980s, not just the four 'little dragons' (Hong Kong, Singapore, Taiwan, South Korea) but also a number of other East as well as South Asian countries have achieved remarkable economic success.

China's economic development during the last decade has been extraordinary (see Table 1). Whilst communism has collapsed in Eastern Europe, China, with a quarter of the world's population, has managed to record a growth rate of nearly 10 percent per annum in the 1980s—by far the fastest growth rate among the world's major economies. Although the pace of economic expansion in South Asia was slower than in East Asia during the last decade, it is notable that countries like India were able to record an appreciable trend increase in their growth rates during the last decade compared with their past records.<sup>1</sup> Table 1 also brings out the opposite experience of the Latin American countries: the region suffered a sharp trend decline and a collapse of its economic growth in the 1980s, which has been aptly described as the 'lost

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<sup>1</sup> As a result of weak governments, fiscal laxness, and unsettled political conditions towards the end of the 1980s, the Indian economy ran into an acute liquidity crisis in 1991. However, as a consequence of the liberalization measures undertaken by the Rajiv Gandhi government in the 1980s, there were also structural factors that made the economy more vulnerable to external as well as internal shocks. See further Singh and Ghosh (1988). See also Planning Commission (1990).

decade' for this continent.<sup>2</sup> When figures in Table 1 are adjusted for the rates of growth of population, and for changes in the terms of trade and net-factor payments, it is found that average per capita *income* in the Latin American countries in 1990 was 15 percent *lower* than that at the beginning of the decade. On the other hand in the South and East Asian economies the corresponding average per capita income rose by 53 percent during the decade (UN 1990).

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**TABLE 1**

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**Growth Performance in the Developing Countries  
by Category<sup>a</sup> and Region<sup>b</sup>**

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	Percentage Average Annual Growth Rate of GDP	
	1965-80	1980-90
Low income economies	4.9	6.1
China	6.8	9.5
India	3.6	5.3
Other low income	4.8	3.9
Middle income economies	6.3	2.5
Sub-Saharan Africa	4.2	2.1
East Asia and Pacific	7.3	7.8
South Asia	3.6	5.2
Latin America and Caribbean	6.0	1.6

<sup>a</sup> The World Bank defines "low income countries" as those with per capita income of \$580 or less in 1989.

<sup>b</sup> For the lists of countries included in each region, see the source listed below.

Middle income countries are defined as those with income per capita of more than \$580 and less than \$6000.

Source: World Bank, *World Development Report 1992*.

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The question of why the Asian countries have been successful and the Latin Americans have failed is of obvious intellectual interest. However, as will be outlined below, because of the specific analyses of this issue by mainstream economists and international financial institutions and the lessons that they draw from them, it is also of critical policy significance. Moreover, from a policy perspective, the experience of East Asian economies like South Korea and Taiwan, not only during the last decade but over a longer period, is also highly relevant. Unlike the South Asian economies, these countries were not only successful during the 1980s but achieved spectacular economic development over the previous two decades as well.

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<sup>2</sup> The 1980s were also a 'lost decade' for the Sub-Saharan African countries. For a discussion of the African experience, see Singh (1987).

This paper has two main aims. The first is to review and to assess alternative explanations of the Asian economic success and the Latin American failure during the last decade (see Section III). Secondly, the paper will examine important aspects of the related question of the long-term development strategies followed by the outstandingly successful East Asian economies (including Japan) over the postwar period (see Section IV). However, to guide the discussion, Section II will set out, in summary form, the main alternative hypotheses in relation to these questions. The chief conclusions will be summed up in Section V.

## **Section II**

### **Alternative Hypotheses about East Asian Success and Latin American Failure**

There is a growing debate on the question of why the East Asian economies succeeded and those in Latin America failed during the last decade. The mainstream perspectives have been put forward in Sachs (1985), Balassa (1986), Maddison (1985), Corden (1990), Summers and Thomas (1993), and in the various reports of the World Bank (see, in particular, World Bank 1991). The main protagonists on the other side of this debate are Fishlow (1991, 1993), Banuri (1991), Ros (1991), Taylor (1992), Singh (1986, 1992a, 1992b, 1992c), and Hughes and Singh (1991).

The essential mainstream argument is that the Latin American economic failure is due mostly to internal causes rather than to international economic forces. It is suggested that both Latin American and East Asian countries borrowed heavily during the 1970s, but the reason that Latin America had a debt crisis and East Asia did not was due to internal mismanagement and inappropriate economic policies followed in the former continent. More specifically, the following charges are laid at the door of the Latin American countries. First, that, in contrast to the East Asians, the Latin Americans misallocated their foreign borrowings at the microeconomic level. They used them for wasteful current consumption rather than for efficient investment in export industries for future debt servicing. Secondly, the Latin Americans long followed import substitution policies and, as a consequence, their industries were inefficient and their economies were not open to foreign competition. East Asians, on the other hand, benefited from their open, export-oriented economic structures. Thirdly, the state had much too pervasive a role in Latin America, leading to rent-seeking, corruption, and economic mismanagement. Fourthly, at the macroeconomic level, the Latin Americans followed incorrect policies; in particular, they had inappropriate exchange rates which led to capital flight, which in turn greatly deepened the debt crisis.

Against this catalogue of Latin American sins, the central point made by Fishlow, Taylor, Singh, and others outside the mainstream is that although the Latin American governments made mistakes, the main reason for the economic failure was the debt crisis caused by external economic forces over which these countries had no control. These authors suggest that the

major changes that took place in the world economy at the end of the 1970s, with the so-called Volcker shock and the adoption of highly restrictive monetarist economic policies in the US and other leading Organisation for Economic Cooperation and Development (OECD) economies, had a disproportionate impact on Latin American countries compared with those in Asia. They point out that, as a consequence, it was not just the East Asian countries who did well in the 1980s; so did the South Asians, even though they have traditionally followed rather different economic policies from those of the East Asian economies.

Further, it is argued that the 'initial conditions' were more unfavorable for the Latin American countries at the beginning of the 1980s than for the Asian economies—the former had on average twice the level of the debt servicing ratio of the latter. In addition, the heterodox authors suggest that the size of the external shocks that the Latin American countries suffered were so large that the normal balance of their domestic political-economic systems was disrupted, causing not only huge macroeconomic instability but also episodes of hyperinflation. The capital flight was thus as much a consequence as a cause of the crisis.

These opposing interpretations of the economic events of the last decade in Asia and Latin America obviously lead to very different policy conclusions. For example, if the orthodox analysis is correct, the broad policy prescriptions of the international financial institutions naturally follow. These essentially consist of two main elements: a) an increase in the role of free markets and private enterprise as far as possible and a reduction in that of the state (through measures such as privatization, deregulation, financial liberalization, etc.); b) a closer integration with the world economy in order to improve resource allocation and enhance technical progress and productivity growth (hence emphasis on measures such as trade liberalization, removal of price 'distortions,' promotion of foreign investment, etc.).<sup>3</sup> If, on the other hand, the heterodox theses concerning intercontinental differences in economic performance in the 1980s are more valid, the above policy recommendations will lose a great deal of their intellectual force. The significance of assessing the validity of the alternative theses outlined above cannot, therefore, be exaggerated.

Turning to the longer-term economic strategies followed by the extremely successful East Asian economies of Taiwan and South Korea,<sup>4</sup> it is very relevant to examine also the case of postwar Japan. This is so for several reasons. First countries like Taiwan and South Korea have tried to imitate the postwar Japanese model of development. Indeed, the Chinese are attempting to do so today. Secondly, although Japanese industrialization began in the 19th century, as late as in the mid-1950s the country only produced 5 million tons of steel and 50,000 cars per annum.

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<sup>3</sup> For a fuller discussion of the policy perspectives of the international financial institutions, see Singh (1992b, 1992c).

<sup>4</sup> Hong Kong and Singapore, which have also been outstandingly successful, must be regarded as special cases as they are small city states. Therefore, the analysis of the East Asian success stories in this paper will consider only Taiwan, South Korea, and Japan.



Many developing countries today have a much higher level of industrial production than Japan had at that time. Thirdly and importantly, there was influential opinion, both inside and outside Japan, that regarded the future economic prospects of the country in the late 1940s to be extremely bleak.<sup>5</sup> However, it took Japan less than two decades to overtake the US in the production of steel and less than three decades to overtake it in the production of cars (Singh 1989).

In the analyses of longer-term economic development in the postwar period in Japan, Taiwan, and South Korea, the main debate concerns two issues: a) the role of state intervention in these economies; b) the nature and degree of integration with the world economy implemented by these countries. The mainstream perspective on the East Asian model has undergone a substantial modification in recent years. It used to be argued (see, for example, Chen 1979; Wolf 1988) that the East Asian economic success arose from the fact that the governments did not intervene and allowed a free play of market forces. In light of the abundant evidence of heavy government intervention in the East Asian countries, this older neoclassical thesis has become increasingly implausible. The current orthodox view is to suggest that although the government did intervene, these interventions were 'market friendly' or 'market conforming' (World Bank 1991; Page and Petri 1993). Moreover, it is argued that an essential ingredient of the East Asian countries' economic success is their close integration with the world economy, their openness to international economic interchange and to foreign competition.

The alternative heterodox interpretation of the East Asian experience emphasizes the fact that the governments in these countries followed strong, purposeful industrial policies (Amsden 1989; Wade 1990; Singh 1992c). The interventions were designed to 'guide' the market rather than to conform to it. Moreover, these countries did not have close integration with the world economy; rather they sought 'strategic' integration. These concepts of 'guiding' the market and 'strategic' integration with the world economy will be made more precise in Section IV.

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<sup>5</sup> World Bank (1991) observes (pp. 13-14): "Extraordinary progress is possible even when countries seem doomed to fail. Forty-three years ago an influential government report in an important developing country observed that labor today shunned hard, productive jobs and sought easy, merchant-like work. The report showed that workers' productivity had fallen, wages were too high, and enterprises were inefficient and heavily subsidized. The country had virtually priced itself out of international markets and faced a severe competitive threat from newly industrializing China and India. It was overpopulated and becoming more so. This would be the last opportunity, concluded the prime minister in July 1947, to discover whether his country would be able to stand on its own two feet or become a permanent burden for the rest of the world. That country was Japan."

### Section III The Contrasting Economic Performances of Asian and Latin American Countries In the 1980s<sup>6</sup>

This phenomenon of more or less uniform economic success of Asian countries and the almost collective economic failure of the Latin American ones in the last decade is truly remarkable from a number of different perspectives. First, as Table 2, which reports the growth rates of nine large Asian and nine large Latin American countries, shows, the median growth rate of the two groups of economies was much the same in the previous two decades.<sup>7</sup> On the basis of these growth rates during 1960-70 and 1970-80, the Asian and Latin American countries cannot be statistically distinguished. It might be expected that if domestic policies were the prime culprit in causing the collapse of economic growth in Latin America in the 1980s, this would affect some countries but not practically all of them (unless they were all following the same policies).

Secondly, this point assumes even more significance in relation to the 'successful' experience of the Asian economies during the 1980s. As noted earlier, it is not only the East Asian 'dragons' that did well in the last decade but also a wide range of other countries in South and East Asia (see Table 2). Yet this group of Asian countries consists of nations that have different political systems, have followed very different economic policies, and display enormous heterogeneity in their overall governance capacity. China has a socialist system whilst other countries in the group are capitalist. Among the capitalist countries, some have had authoritarian regimes (e.g., Indonesia) while others are more democratic (e.g., India). Moreover, countries like Korea have followed export-oriented policies while India has been a classic example of vigorous import substitution. Notwithstanding this diversity, as Table 2 shows, during the 1980s none of the Asian countries other than the Philippines had a growth rate of less than 4 percent during the 1980s. In Latin America, on the other hand, only two countries (Brazil and Chile) reached a growth rate of more than 3 percent. Similarly Table 3 indicates that although the Latin American countries were somewhat more inflation prone than the Asian countries both in the 1960s and 1970s, their inflation rate greatly accelerated in the 1980s.

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<sup>6</sup> In writing this section I have drawn on my previous papers; see Singh (1986,1992a) and Hughes and Singh (1991).

<sup>7</sup> Since economic policies are carried out at the individual country rather than the continental level, the median is a better summary measure of central tendency than the weighted average (weighted by GDP) used, for example, in Sachs (1985). The latter measure will simply reflect much more the experience of the larger economies.

<b>TABLE 2</b>			
<b>GDP Growth Rate in Asian and Latin American Countries (percent per year)</b>			
	1960-70	1970-80	1980-90
<b>Asia</b>			
China	5.2	5.8	9.5
India	3.4	3.6	5.3
Indonesia	3.9	7.6	5.5
South Korea	8.6	9.5	9.7
Malaysia	6.5	7.8	5.2
Pakistan	6.7	4.7	6.3
Philippines	5.1	6.3	0.9
Sri Lanka	4.6	4.1	4.0
Taiwan	...	...	...
Thailand	8.4	7.2	7.6
Median	5.2	6.3	5.3
<b>Latin America</b>			
Argentina	4.2	2.2	-0.4
Bolivia	5.2	4.8	-0.1
Brazil	5.4	8.4	2.7
Chile	4.5	2.8	3.2
Colombia	5.1	5.9	3.7
Ecuador	...	8.8	2.0
Mexico	7.2	5.2	1.0
Peru	4.9	3.0	-0.3
Venezuela	6.0	5.0	1.0
Median	5.1	5.0	1.0

Source: World Bank 1982, 1989.

### International Economic Shocks

The foregoing discussion suggests indirectly that there must be some common international factors at work which may have caused this intercontinental divergence in economic performance in the 1980s. However, Sachs (1985) and Balassa (1984) assert that the impact of international economic shocks was no different in the Latin American countries from that in the Asian economies. This assertion is contested by Singh (1986), Hughes and Singh (1991), and Fishlow (1991). The far-reaching changes in OECD economic policies at the end of 1970s, symbolized by the 'Volcker shock,' led to a prolonged world economic recession and unprecedentedly high interest rates. In the non-neoclassical real world of imperfect wage-price flexibility, unemployment, and balance of payments disequilibria, these events affected Less Developed Countries (LDCs) through four main channels: a demand shock to LDC exports; a

consequent fall in commodity prices and a terms of trade shock; the interest rate shock; and a capital supply shock.<sup>8</sup>

TABLE 3

Rates of Inflation in Asia and Latin America, 1960-1990 (average annual percentage growth of consumer price Index)<sup>a</sup>

	1960-70	1970-80	1980-90
<b>Asia</b>			
China	...	...	5.8
India	7.1	8.5	7.9
Indonesia	...	20.5	8.4
South Korea	17.4	19.8	5.1
Malaysia	-0.3	7.5	1.6
Pakistan	3.3	13.5	6.7
Philippines	5.8	13.2	14.9
Sri Lanka	1.8	12.6	11.0
Taiwan	3.5	12.2	...
Thailand	1.8	9.9	3.3
Median	3.4	12.6	6.7
<b>Latin America</b>			
Argentina	21.7	130.8	395.1
Bolivia	3.5	22.3	318.2
Brazil	46.1	36.7	284.4
Chile	33.2	185.6	20.5
Colombia	11.9	22.0	24.8
Ecuador	...	14.4	36.7
Mexico	3.6	19.3	70.4
Peru	10.4	30.7	233.7
Venezuela	1.3	12.1	19.3
Median	11.1	22.3	70.4

<sup>a</sup> GDP deflator for 1980-90  
Source: World Bank (1982, 1992).

Fishlow points out that Sachs considers only two of these external shocks—the interest rate and the terms of trade shocks. Balassa does consider the effects of the demand shock as well, but on the restrictive assumption of a constant market share. However, neither of them considers the most important external shock as far as the Latin American countries were concerned, namely the capital supply shock. Following the Mexican debt crisis in 1982, the Latin American countries were severely credit-rationed by the international banking system.

<sup>8</sup> See, further, Singh (1986a) and Dornbusch (1985). Dornbusch correctly notes that in the neoclassical world of perfect wage-price flexibility, full employment, and balance of payments equilibrium, only two of the external shocks mentioned in the text are relevant, namely the terms of trade and interest rate shocks.

To illustrate the nature of the capital supply shock, consider the case of Mexico. During the oil boom years, 1977 to 1981, the Mexican economy had been growing at a rate of 7 to 8 percent per annum with even the nonoil GDP rising at a roughly similar rate. However, despite the enormous increase in oil exports, the balance of payments position had been deteriorating. The current account deficit rose from nearly 5 billion dollars in 1979, to almost 7 billion dollars in 1980, and to 11.7 billion dollars in 1981. Notwithstanding this deterioration, the international banking community was happily willing to lend Mexico ever increasing amounts to finance the deficits. Thus, from 1978 to 1981, while international bank loans to developing countries as a whole increased by 76 percent, they rose by 146 percent to Mexico, already a large debtor in 1978.

To meet the Mexican government's increased demand for foreign loans to finance the current account deficit, international banks accelerated their lending to Mexico in 1981, albeit with an increasing shortening of the term structure of the new loans (Ros 1986). In 1981, the capital account of the balance of payments indicates that Mexico's net public short-term liabilities rose by \$12.7 billion (compared with \$6 billion in 1980 and \$1.7 billion in 1979). However, in the crisis year of 1982, these capital flows were abruptly halted and the capital account shows that Mexico's net public external short-term liabilities actually *decreased* by \$614 million. Brailovsky and Barker (1983) note correctly that this capital supply shock had a devastating effect on the Mexican economy.

Most of the other Latin American economies were subject to similar capital supply shocks. These emanated from what Williamson (1985) has named the 'contagion effect'<sup>9</sup> whereby, in the wake of the Mexican debt crisis in 1982, voluntary private capital flows to most Latin American countries were greatly reduced if not stopped altogether. The most important point is that because of the 'contagion effect,' capital flows were reduced in much greater amounts, as well as much more suddenly, to the Latin American than to the Asian economies.

Moreover, Singh (1986) and Hughes and Singh (1991) suggest that reduced world economic growth and world trade during 1980-82 had a differential impact on the normal export markets for countries in the two continents. In particular, the Middle Eastern market, which was the most rapidly expanding market during this period, was much more significant for many of the Asian countries than for Latin America. There are two important channels by which the Asian countries benefited from the economic prosperity in the Middle East: a) workers' remittances, and b) the growth of merchandise exports. In addition, as noted earlier, Hughes and Singh's analysis also indicates that the Latin American countries began the decade with worse initial conditions than the Asian countries: their debt servicing ratio was twice that of the Asian countries.

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<sup>9</sup> Williamson (1985) observes: "South Korea got closer to the brink in 1980 as a result of the overexpansionary policies in 1979 and large external shocks; had it been in South America and therefore subject to contagion, it might have succumbed" (p. 569).

Fishlow and Hughes and Singh argue that if all the external shocks that affected the developing countries at the beginning of the last decade (the demand shock, the terms of trade shock, the interest rate shock, and the capital supply shock) are taken into account—as, indeed, they should be—their combined effect on the Latin American balance of payments was much more severe than on that of Asian countries. Deterioration in the balance of payments' position of a developing country has extremely serious consequences for all spheres of the economy, real as well as financial. The effect on industrial production is direct and for many countries immediate. The external payments constraint can become so binding that the country has to curtail not only the import of luxuries, or other consumer goods, but also the essential imports required for maintaining the existing level of domestic production. Agricultural production is affected both directly by the foreign exchange constraint and indirectly by reduced industrial production. Reduced imports as well as lower domestic production of fertilizers and other agricultural imports, together with lower oil imports, hamper agriculture production directly. Indirectly there is an unfavorable effect on production because of the reduced availability of the so-called incentive goods to farmers (soap, bicycles, etc.). However, import compression not only threatens agricultural and industrial production but, paradoxically, also lowers exports. Khan and Knight (1988) provide empirical evidence in support of this phenomenon.

Import strangulation and a balance of payments constraint also generate inflation and disequilibrium in government finances. Since sales and excise taxes on industrial production as well as import duties are a major source of government revenue in many developing countries, the balance of payments constraint is directly and indirectly responsible for the enormous increases in budget deficits or the public sector borrowing requirements that these countries have been experiencing in the 1980s. In the institutional circumstances of the heavily indebted Latin American economies, there is an important additional reason why such a constraint has generated a fiscal crisis. This arises from the fact that foreign debt has been consolidated in these countries to become largely the liability of the government and there is therefore a huge burden of interest payments on the budget. Sachs (1987) provides data to show that in Argentina and Mexico in the mid-1980s, interest payments represented nearly a third of the government's revenues.

As the government in many Latin American countries has a direct and major role in undertaking or financing industrial activity and investment, the fiscal crisis leads particularly to reduced industrial and infrastructural investment. A number of studies on macroeconomic adjustment in developing countries carried out at the World Institute of Development Economic Research at Helsinki (WIDER) have shown that, in general, public investment in the Global South 'crowds in' rather than 'crowds out' private sector investment (see Taylor 1988). This compounds the effects of the fiscal crisis on long-term economic development.

In view of all the direct and indirect effects of the foreign exchange constraint and the balance of payments crisis brought about by world economic developments, it is not surprising to observe the poor industrial and overall economic record of the Latin American countries during the last decade, relative to the Asian countries.

### **Size of External Shocks and the Political Economy of Adjustment**

In addition to the foregoing analysis, there are three other points that require attention. First, it should be observed that the external shocks that many Latin American countries suffered in the early 1980s were gigantic. It requires an enormous economic and social effort as well as a considerable period of time to recover from the disruptions caused by such shocks. To illustrate with an example from an advanced economy, it may be recalled that the impact of the adverse movements in the terms of trade for the United Kingdom (not then an oil exporter), largely as a result of the first oil shock in 1973-74, is estimated to have been equivalent to a reduction in GDP of about 4 percent. This led to an enormous redistributive conflict and to a near doubling of the rates of inflation and unemployment. The government was obliged to undertake extraordinary measures (including, in 1976, the rare step for an advanced economy of a recourse to the International Monetary Fund) to restore economic stability. The record indicates that the combined effect of the various international economic shocks on a wide range of developing countries which are much poorer, particularly those in Latin America and Africa, was often three to four times as large as the external shocks that the UK suffered in the mid-1970s (see, further, Singh 1992a).

Secondly, apart from the huge task of adjustment to these shocks at the beginning of the decade, it needs to be stressed that for many developing countries, again particularly for those in Latin America and Africa, a number of the same adverse external factors continued to operate throughout the 1980s. Table 4 reports the terms of trade for various groups of developing countries in the 1980s. The Table shows that for the Latin American countries the terms of trade fell by nearly 20 percent over the period 1980 to 1988; for Sub-Saharan African countries they fell by more than 30 percent. However, for South Asian countries and East Asian NICs there was a small improvement in the terms of trade over this period.

More importantly, unlike the Asian countries, Latin American economies continued to be severely credit-rationed for much of the decade. Partly as a consequence, there was a massive 'reverse' flow of capital from these countries to the advanced countries. Thus, in the mid-1980s, there was a negative transfer of resources abroad from Latin America in the order of \$40 billion

annually, amounting to as much as 5 percent of the GDP of these countries. This contrasts with the normal picture of a positive net resource flow of about \$5 billion annually in the late 1970s.<sup>10</sup>

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**TABLE 4**

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**Terms of Trade of Developing Countries, 1980-1988  
(1980=100)**

	81	82	83	84	85	86	87	88
China	n.a.	106	100	97	95	83	87	84
South Asia	89	99	103	99	101	110	111	113
East Asian NICS (a)	95	100	101	100	101	102	100	101
East Asian NICS (b)	95	103	103	103	104	107	104	105
Latin America	101	103	102	99	96	82	80	81
Sub-Saharan Africa	99	94	94	96	90	71	73	69
Industrial Market Economies	98	101	101	102	103	114	114	114

Source: Ros (1991).

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Third, an essential part of the heterodox analysis is that it is not the case that the Latin American countries were incompetent or unaware of the desirability of balanced budgets, etc., but that the economic shocks many of them suffered were so gigantic that their social and political institutions simply could not deal with the ensuing redistributive struggles over a diminished national cake. Hence many of them experienced episodes of hyperinflation and extreme macroeconomic instability. This also led to capital flight which was greatly facilitated by the fact that most Latin American countries (Brazil being a notable exception) did not have exchange controls of the kind that the Asian countries did (see section on 'Openness and Economic Structure' below). In a negative feedback dynamic, capital flight was therefore as much a consequence of the debt crisis as a cause of it.

With respect to the question of the macroeconomic policy errors made by the Latin American countries, two points are important. First, as Ros (1991) notes, policy mismanagement undoubtedly played a role, but policy mistakes were generally rapidly corrected and can hardly explain one decade or more of retrogression. Ros also argues that public spending booms were present in the late 1970s in some of both the subsequent good and bad performers (South Korea, Turkey, and Sri Lanka as compared to Mexico and Brazil), and that they were absent or

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<sup>10</sup> The source of these figures is Coria, Jolly, and Stewart (1987). The figures of net resource transfer given in the text are calculated as current account balance less interest payments.



rather moderate in some of both types of countries. Secondly, and more importantly, the issue of macroeconomic policy mistakes can only be properly addressed in the overall context of the size of the shocks that the Latin American countries were subject to and the constraints imposed by the political economy of adjustment.

### **Microeconomic Inefficiencies and Misallocation of Resources**

We turn now to the mainstream view that the Latin American countries misallocated and wasted the loans they obtained—that they used them for current consumption, and when they invested it was in inappropriate ‘white elephant’ projects which would yield returns, if at all, only over a long period of time. These issues are systematically explored by Fishlow (1991). Fishlow’s analysis of the consumption functions of Latin American and East Asian countries indicates that the former did not use external borrowings to finance current consumption any more than the latter did. He notes: “At the margin, therefore, there was an expected substitution for domestic savings. But there seems to be no difference in this respect between Indonesia and South Korea, on the one hand, and Brazil and Mexico on the other” (p. 153).

As far as the allocation of investment resources is concerned, it was not just Mexico or Brazil but also South Korea that used foreign loans in the 1970s to launch ambitious programs of import substitution and development of heavy industries. The reason for this investment drive was, of course, the negative or extremely low real interest rates that prevailed at that time. *Ex ante*, therefore, the market signals pointed towards increased investment. However, all these programs, including those of South Korea,<sup>11</sup> ran into supply-side bottlenecks and teething troubles of various kinds. The main reason why the Korean program eventually succeeded while the Brazilian and Mexican ones did not was the far more severe foreign exchange constraint to which the latter two countries were subject.

It is worth recalling that the South Korean government’s investments in heavy industries during the 1970s were much criticized in orthodox economic circles. However, these investments more than redeemed themselves in the 1980s by providing the main basis of the highly successful South Korean export drive during that decade (Amsden 1989). Similarly, Ros (1991) notes that a large part of Mexico’s problems in the 1980s have their origin in the fact that a substantial share of the debt acquired during the 1970s at low real interest rates was used to build and expand its oil industry and exports at a time when oil prices were very high and *expected* to remain high, while interest rates were expected to remain low. It was the very sudden change in these prospects that sharply reduced the profitability of previous investments and Mexico’s credit worthiness.

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<sup>11</sup> See, further, Park (1986) and Fishlow (1991).

## **Openness and Economic Structure**

Balassa (1984), Sachs (1985), and other mainstream economists, as well as international financial institutions (see, for example, the World Bank 1991), suggest that a very important reason for the superior Asian economic performance during the last decade is that these countries had more open and export-oriented economic structures compared to those in Latin America. There are, however, a number of points that cast doubt on this proposition. First, as Hughes and Singh observe, the Latin American countries were in fact much more open to the international economy, at least on one dimension, than the Asian economies. The former generally had larger degrees of currency convertibility and practiced a far greater degree of financial openness than the latter. Most Asian countries had fairly strict exchange controls.

Secondly, differences in economic and industrial structures have been examined in detail in Singh (1985) and Hughes and Singh (1991). This analysis reveals very little evidence in support of the Balassa-Sachs openness hypothesis. The least open Asian economies, like China and India for example, were able to cope at least as effectively with the world economic crisis in the 1980s as the highly export-oriented South Korean economy. As for export orientation, United Nations Industrial Development Organization (UNIDO 1984) data show that during the decade of the 1970s, Brazilian manufactured exports expanded at much the same rates as did South Korean exports. Moreover, Mexico's and Argentina's manufactured exports grew much faster than India's during that decade. Hughes and Singh conclude from their analysis that the Latin American countries were derailed by exogenous shocks, in large measure because of their greater financial integration with the world economy, their greater borrowings, and their open financial markets, rather than their closed trading regimes.

### **Section IV East Asian Economies: Long-Term Development Strategies**

We turn now to an examination of the long-term economic strategies followed by the successful East Asian economies—specifically South Korea, Taiwan, and postwar Japan.

#### **The Role of the State**

Until recently, neoclassical writers contrasted the limited role of government in the East Asian countries with its pervasive involvement in the economies of Latin America. However, as noted before, this simplistic view cannot be sustained any longer in light of the widely acknowledged fact that the East Asian governments intervened heavily in all spheres of their

economies. If the differences in economic performance of the East Asian and Latin American economies in the 1980s is to be attributed to the role of the state, the argument clearly has to be made not in terms of the extent but rather with respect to the nature and quality of the government interventions.

This is, indeed, what the World Bank's *World Development Report* for 1991 does. The report, on the basis of its analysis of successful and unsuccessful economies during the last four decades (specifically including postwar Japan and the other high performing East Asian countries), advocates a so-called market-friendly approach to development. 'Market friendly,' it is explained, means the following: a) *intervene reluctantly*, i.e., let markets work unless it is demonstrably better to step in; b) *apply checks and balances*, i.e., put interventions continually to the discipline of international and domestic markets; c) *intervene openly*, i.e., make interventions simple, transparent, and subject to rules rather than official discretion. The state's role in economic development in this new formulation is regarded as being important but best limited to providing the social, legal, and economic infrastructure, and to creating a suitable climate for private enterprise.

The important question in the present context is to what extent, if any, did the governments in Japan, South Korea, and Taiwan follow the market-friendly approach in the terms outlined above. Considering first the case of postwar Japan, there is overwhelming evidence, generally accepted amongst scholars in the field, that the government in Japan did not intervene 'reluctantly.'<sup>12</sup> On the contrary, it pursued a forceful and aggressive industrial policy to change the unsatisfactory economic situation faced by the country at the end of the 1940s. The cornerstone of this industrial policy was the so-called structural policy aimed at adaptation and technological development of certain specific industries (steel, chemicals, machinery, and other heavy industries) thought to be vital for the rapid growth of productivity and per capita incomes.

The government used a variety of instruments to bring about a rapid structural transformation of the Japanese economy between 1950 and 1973, the period of its most rapid growth. The most important of these were bank finance and directed credit, import controls and protection, restrictions on entry and exit of firms in the domestic market, control over foreign exchange and, not least, controlled importation of foreign technology. Although 1950–73 is the relevant reference period from the LDC perspective, it is notable that Japanese structural policy has continued to this day, though in a different form.<sup>13</sup>

The Japanese government did not simply attempt to concentrate resources to promote specific industries; its role in the country's industrial development was deeper and far more

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<sup>12</sup> See, for example, Magaziner and Hout (1980), Shinohara (1982), Dore (1986), Yamamura (1988), Okimoto (1989), and Matsumoto (1992).

<sup>13</sup> See, for example, Johnson, Tyson, and Zysman (1989).

intrusive. It extended to the level of the individual firm: the Ministry of Industrial Trade and Industry (MITI) accorded preferential treatment to the specific firms that were thought to best fulfill its aims. As for the 'transparency' of this intervention, MITI's widespread use of 'administrative guidance' was the exact opposite of the 'market-friendly' specification (see, for example, Caves and Uekusa 1976).

As several scholars have noted, the other East Asian 'dragons,' notably South Korea and Taiwan, have also each followed a purposive and comprehensive industrial policy (see, among others, Johnson 1987, Amsden 1989, and Wade 1990). These countries have been greatly influenced by the Japanese example and practice. In view of their relative backwardness compared with Japan, state intervention in these economies has been even more far-reaching than in Japan. For example, in addition to the industrial policy instruments used in Japan, South Korea also employed 'heavy' subsidization and the 'coercion' of exports. Moreover the government helped create large-scale conglomerate firms, encouraged mergers of specific corporations, and in general controlled entry and exit of firms (Amsden 1989).

Similarly, for Taiwan, Wade (1990) documents the widespread and intensive use of state industrial policy to purposefully guide the market economy. It is certainly not a picture of some night-watchman state intervening 'reluctantly'. Until the early 1980s, both South Korea and Taiwan had nationalized banks (and most of their banks are still state owned), and in both countries, state-directed credit to favored sectors and firms was an important device for planned industrial development. Moreover, it is notable that the public enterprise sector in Taiwan is one of the largest among the developing mixed economies. It is bigger than India's or that of Argentina, Brazil, or Mexico. The public enterprises have contributed 13-14 percent of GNP and a third of gross fixed capital formation in Taiwan over the years 1950-1975, a period that witnessed the most rapid economic and industrial growth in that country (Chang and Singh 1992, Short 1984).

Thus, among them, Japan, South Korea, and Taiwan, did most things that the market-friendly approach rejects. The *World Development Report* for 1991 argues that "these economies refute the case for laissez-faire." The experience of these countries is certainly an argument against laissez-faire; it also provides no support for the command planning of production of the Soviet type, which in effect supplants the market altogether. However, for mixed economy developing countries with strong states, it is unequivocally an argument for adopting an industrial strategy, for guiding the market, and not for following a hands-off market-friendly approach.

Finally, how does the long-term role of the state in the East Asian economies compare with that in Latin American countries such as Brazil and Mexico? Here there are a number of points that are relevant. First, as political scientists suggest, the state in Latin American countries is

unable to act as effectively as a developmental state as the governments of the East Asian countries.<sup>14</sup> In view of its historical evolution and the nature of the relationships it has with various social groups (e.g., labor, landed interests), the Latin American state has much less autonomy than its counterpart in East Asia. Nevertheless, it is important to observe that the Mexican and Brazilian governments do have conspicuous economic successes to their credit. With heavy state interventions, for three decades between 1950 and 1980 the Mexican economy expanded at a long-term rate of nearly 6 percent per annum—a highly respectable performance by comparative international standards. More significantly, with vigorous state involvement, the Brazilian economy recorded a growth rate of nearly 10 percent per annum during 1965-1980—probably the fastest growth rate of any country over this period. The important point here is that although the nature and effectiveness of state intervention differed between East Asian states and Latin American countries like Mexico and Brazil, the latter were performing very well until the debt crisis of the 1980s.

#### **The Nature and Degree of Integration with the World Economy**

How far did the leading East Asian countries integrate with the world economy in the course of their long-term economic development during the last three to four decades? Notwithstanding the nostrums of mainstream economists and international financial institutions with respect to the virtues of openness, external competition, and close integration with the world economy, the fact of the matter is that the actual practice of Japan, South Korea, and Taiwan does not at all accord with these prescriptions. During their periods of most rapid growth, these nations did not attempt a deep and close integration with the world economy. Rather they sought a *strategic integration*, that is, they integrated in the direction and to the extent necessary for promoting national economic growth. For example, the Japanese economy operated under rigorous import controls, whether formal or informal, throughout the 1950s and 1960s. As late as the end of the 1970s, manufactured imports constituted only 2.4 percent of the Japanese GDP; the corresponding proportion in the UK and other European Economic Community (EEC) countries was five to six times larger (CEPG 1979). As for openness to the international capital markets, Sachs (1987) notes that the domestic Japanese capital markets were highly regulated and completely shut off from the world capital markets for most of this period. Only the government and its agencies were able to borrow and lend abroad. Foreign direct investment was strictly controlled. Foreign firms were prohibited either by legal or administrative means from acquiring a majority ownership in Japanese corporations.

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<sup>14</sup> See, for example, Evans (1991) and Fishlow (1990, 1991).

The situation in South Korea was broadly similar in these respects to that in Japan. The Koreans also had strict import controls and restrictions on foreign direct investment, as well as closed financial markets to international competition. As noted earlier, in contrast, the Latin American economies like Brazil and Mexico were, in fact, more open in important dimensions—for example, in relation to foreign direct investment and to international financial markets.

Singh (1992c) points out that an important difference between the Latin American economies and the Asian economies in this area lay in their respective policies towards exports. He suggests that in Japan and Korea there was a positive bias in favor of exports—as opposed to 'level playing fields'—throughout their periods of rapid growth. This was achieved in these countries largely through industrial policy instruments such as the use of performance criteria on exports and on market shares. Companies recognized that to move forward, to have access to foreign technology, licenses, etc., they had to export.

## **Section V Conclusion**

This paper has argued that contrary to the mainstream theses and those of international financial institutions, the chief reason for the collapse of economic growth in Latin America and the success of Asian economies during the 1980s was the differential size of the external economic shocks to which the two groups of countries were subject. These shocks emanated from the prolonged OECD economic recession that followed in the wake of major changes in economic policy in the US and other advanced economies at the end of 1970s. If all the external shocks (the demand, the terms of trade, the interest rate, and the capital supply shocks) are considered, their combined adverse impact on the balance of payments of the Latin American economies was greater than that on the Asian countries. The Latin American countries were particularly hard hit by the capital supply shock which is either ignored or not properly examined in the mainstream contributions.

The effects of these international economic shocks at the beginning of the decade were compounded for the Latin American countries by the deterioration in their terms of trade as well as by their remaining severely credit-rationed for most of the 1980s. The paper argues that the magnitude of the external shocks to which the Latin American countries were subject was so large that not only did they have a major impact on the real economy and its future growth prospects but, equally importantly, the ensuing redistributive struggle over reduced economic growth also greatly disturbed the normal balance of political forces in these societies. This in turn led to extreme financial and monetary instability and episodes of hyperinflation. There are good reasons to suggest that if the rich countries such as the UK and the US had been afflicted with anywhere

near the same kind of shocks, they would most likely have fared worse and probably suffered a decade-long depression.

An examination of the longer-term development strategies of the East Asian economies reveals that the state in these countries did not follow the World Bank's revised formulation of a 'market-friendly' approach to development. Rather, the governments in Taiwan, South Korea, and Japan played a vigorous economic role and pursued a highly active industrial policy. The state did not supplant the market altogether as did the 'command' planning of production of the Soviet type. But nor did it simply follow the market. Instead, a whole plethora of government measures were used to guide the market towards planned structural change. Similarly, the East Asian countries did not seek or practice a close integration with the world economy during their periods of rapid growth; they integrated only in the directions and to the extent to which it was useful for them to do so.

The paper has also argued that although for historical reasons the governments in Latin American countries such as Mexico and Brazil have not had as much 'autonomy' as the East Asian governments did, the long-term development record of the former over the postwar period until the debt crisis of the 1980s has overall been a highly creditable one. It is worth reiterating that the heavily interventionist Brazilian government guided the development of the economy in the 'miracle' years of 1965-1980, when Brazil had by far the fastest growth rate of any leading country.

Finally, it is important to draw attention to the fact that although the economic collapse of the Latin American countries in the 1980s was due to international economic forces beyond their control and not due to domestic mismanagement, nevertheless these countries must improve their internal organization and resource utilization if they are to recover their long-term growth rates of 1950-1980 and fully resume their industrial revolution. This is particularly so because there are strong grounds for believing that international economic conditions are unlikely to improve noticeably over the next decade; the expansion of the world economy in the foreseeable future will at best be at its slow post-1973 trend rate and it is also likely to be subject to considerable fluctuations.<sup>15</sup>

In these circumstances, the prescriptions of the international financial institutions are certainly not the only way for the Latin American and other developing countries to enhance their economic performance. Whether or not it is still the best way is the important historical question facing these governments today. The central conclusion of this paper is that the analytical bases for and the historical evidence in favor of such policies—either in the experience of Asian and Latin American countries during the 1980s or in the longer-term development strategies of the successful East Asian economies—are very far from being adequate.

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<sup>15</sup> For a fuller analysis of the medium-term prospects for the world economy, see Glyn, Hughes, Leipitz, and Singh (1991). See also Singh (1990).

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