Articles & Commentaries

p-Guru

by Dr. Hiwhoa Moon, renowned economist and academic, has held key appoint•ments in organizations under the Ministry of Trade, Industry and Energy and Ministry of Economy and Finance, Republic of Korea. Among other portfo•lios he held were: country economist, World Bank; Adjunct Professor, Columbia University, New York; Chairman and CEO, Korea Productivity Center; and APO Chairman. He is now Adjunct Professor, Yonsei University, and advisor to UGCom Co. Ltd., after retiring as Professor/Dean, School of Economics and International Trade, Kyung Hee University, Republic of Korea.

A Strategy for Economic Growth and Higher Productivity in East Asian Economies

The economies of East Asia, which demonstrated impressive dynamic growth over a sustained period and hence served as a power center for global economic growth, have lately experienced a few common problems. These problems, unfortunately, pose a serious threat to growth and productivity gains in those economies.

The first problem is the rapid aging of the population structure. These demographics are likely to lead to reduced economic growth since at best the increase in the labor input for national production activities will be reduced, or in the worst case the absolute amount of the labor input will be reduced due to the decrease in the economically active population. The aging population structure will also increase the burden on people currently employed and supporting the elderly. Under these circumstances, the best policy to minimize the downward trend of economic growth and the subsequent low gains in national productivity is increasing the productivity of the current labor force. Programs such as extensive government support for skill upgrading or speedy introduction and dissemination of IT in all job sites could increase labor force productivity.

The second problem is that East Asian economies suffer from a hollowing out of their traditional labor-intensive industries as well as of some new high-tech industries because of relocation to China, due mainly to the differences in relative wages, market size, and business environment between China and its counterparts. This hollowing out is marked in the Republic of Korea, Japan, the Republic of China, and Thailand. The trend appears to be gaining momentum. The loss of key industries in some East Asian countries deprives their economies of dynamism and hence the potential for productivity gains. One important government strategy to deal with this problem is encouragement of “capital deepening” and restructuring in the sectoral distribution of industries within the economy. Capital deepening means that the ratio of the entire capital stock to the total labor force within a national economy is increasing through, for example, increased capital investments, with a given labor force size. Sectoral restructuring implies that industries utilizing IT, intensive knowledge, or other high technologies to generate high value added will replace traditional industries, which rely heavily on low wages and lower technologies. To implement these strategies, the government can offer, for example, tax breaks on investments in these new future-oriented industries. Sweeping deregulation could also be introduced to facilitate the easy exit of sunset industries and entry of new ones.

The third common problem faced by East Asian economies is that after the Asian financial crisis, most witnessed fewer business loan transactions, with financial institutions reluctant to lend and corporations reluctant to borrow. These extremely pessimistic and bearish attitudes developed because during and immediately after the crisis, banks with large outstanding loans and firms with heavy debts suffered the most. This led to serious insolvency problems for financial institutions, largely triggered by massive business defaults. One serious effect of this bearish atmosphere is low investment and subsequent low economic growth, which inevitably lead to low productivity increases. Generally investments in new business capital formation or even in the expansion of existing production lines accompany new technologies, since investments result in the installation of machinery and equipment with better technology. It is also true that higher-tech machinery yields higher productivity.

Numerous policy options have been tested by Asian governments to deal with the problems of low investment and low economic growth. However, the majority of those options were designed to deal with the simple downward trend of business cycles, rather than with a prolonged trend of low investment and low economic growth caused by pessimism concerning the future following the Asian financial crisis. Countries are therefore likely to fall into the hopeless trap of secular low economic growth, unless drastic policy changes are introduced. A typical example is the Korean economy. The Republic of Korea's prolonged low economic growth is a serious hangover from the financial crisis. Nevertheless, numerous other factors such as political uncertainty, inconsistency in government policies, militant unions, and the prevalent anti-business environment since the inauguration of the present government should also be blamed for the failure to revitalize economically.

The Korean case suggests that there is no simple solution to deal with the problems of low investment and low economic growth-cum-low productivity increases triggered by the financial crisis. The few relevant factors cited above as responsible for the Korean problem of sustained low growth should be tackled decisively by the government. However, the bearish business behavior in economies that show similar long-lasting trends of low investment and sluggish economic growth following the Asian financial crisis is due to painful experiences of massive business defaults and insolvencies of financial institutions during and after the crisis. Despite the fact that the business firms and financial institutions that survived the crisis underwent serious internal restructuring, either upon government instruction or voluntarily, the pain and costs borne deterred firms and banks from making aggressive investments and loans. Therefore, unless hefty profits from new investments are guaranteed, this extreme bearish mentality in some East Asian economies will continue rather than abate.

Bearish business behavior can be witnessed even in countries the f inancial crisis did not hit directly. Singapore, Malaysia, the Republic of China, and Japan witnessed the devastating impact of the crisis on neighboring economies and the spillover into their own through rapid contagion. Under these circumstances, governments should provide maximum encouragement to the business sector to increase economic activities, based on the understanding that this is no time to rely on traditional policy tools if sagging economies are to be rekindled. Only drastic and aggressive government incentives and actions can reverse the deep-rooted pessimism of the business sector. One or two minor policy changes will not redress the situation. A comprehensive, well-orchestrated, and decisive package of policies should be launched if substantive results are to be obtained. The most important element in this new policy package is the removal of factors that have discouraged active investment. The removal of militant unions, inconsistencies in government policies, and business-unfriendly attitudes shared by governments and some politicians should precede the full deployment of policy packages aimed at revitalizing the economy through the encouragement of business investments. Only when economic growth is rekindled in this manner can productivity gains be expected.

The fourth problem faced by some East Asian economies is a by-product of the fact that speedy globalization and restructuring following the Asian financial crisis opened up securities markets in most, leading to substantial increases in foreign-held shares in corporate equity. These increases in foreigners' shareholding sometimes resulted in their takeover of management or their accumulation of majority shares in corporations. Thus major corporate policies are decided by foreigners. While there are many virtues in the majority ownership of shares by foreigners, it sometimes forces corporations to make decisions based on short-term perspectives rather than on long-term perspectives. A typical feature resulting from increased foreign ownership of corporate equity is that foreign shareholders prefer large current-term dividends rather than longer-term investments, which may promise larger profits and at the same time would be beneficial for the entire national economy concerned. For example, the construction of a semiconductor plant requires a massive amount of funds as well as a few years' gestation period before yielding meaningful profits. Therefore, following the direction of the foreign majority shareholders, corporations may allocate the largest chunk of current profits to immediate dividends instead of to long-term investment that may guarantee attractive profits in future. This strong preference for short-term dividends is more evident in corporations where short-term multinational hedge funds, instead of long-term foreign direct investors, hold the majority shares. Again, less investment means lower economic growth and smaller productivity gains.

Another by-product of the drastic opening of securities markets in East Asian economies following the Asian financial crisis is that the local owners of large conglomerates want to hold onto large sums of cash instead of investing them in profitable projects. This behavior occurs because the ownership and management of important local firms were taken over by foreign portfolio investors through purchases of significant volumes of shares, leading to hostile mergers and acquisitions (M&As). Therefore, local majority shareholders, fearing hostile M&As by foreign investors, want to keep sufficient cash to acquire the shares needed to prevent this. Holding large sums of money by local owners or managers will inevitably limit the funds available for investment in profitable, value-generating new projects.

Dealing with the fourth problem of the East Asian economies appears complex. The strong preference for immediate dividends by foreign investors and the preference for cash by local owners or managers of large firms became marked after the Asian financial crisis. Therefore, not much experience related to this issue has been accumulated, and few policy tools have yet been tested.

Nevertheless, strong incentives encouraging investment based on the principle of market competition as described above should be devised and applied. Even so, this fourth problem seems extremely difficult to resolve fully.

Back to list

To top of page