

East European Challenges to East Asia (*)

Christopher Lingle (**)

Abstract

The 1980's ignited a universal trend towards economic liberalization. This momentum has eclipsed previous attempts to open up world trade. The globalization of capital markets is perhaps the most distinctive element of what might be termed a "New World Economic Order". Globalized capital markets involve a flow of "quicksilver capital" that flows through geographical borders and defies political boundaries. Countries with "capital friendly" institutions shall attract the interest of itinerant investors, either as foreign direct investment, equity investments or lending.

Thus, comparative advantage in the 1990's shall depend upon institutional arrangements that provide opportunities for profitable operations. In the end, those countries with the greatest predisposition for flexible and responsive institutions shall be able to develop and to maintain comparative advantage in the New World Economic Order.

East and Central European countries are in a position to develop a new set of institutions that may allow them to displace East and Southeast Asia as a net recipient of direct investments and portfolio capital. First, East and Central European countries are beginning with a "clean slate" of institutions due to their radical transformation. Second, their labor is highly skilled (surplus) with high productivity and low real wages. They also have ready access to mature (import-oriented) markets. Finally, Europeans tend to display more of the necessary qualities of a true entrepreneurial class. Real entrepreneurs tend to exhibit an iconoclastic willingness to challenge the status quo, including questioning of governmental authority. Embodied in this entrepreneurial spirit is an unrelenting sense of individualism.

Since these conditions and characteristics are mostly absent in an Asian setting, East and Central European countries have a unique opportunity to set off upon their own miracle path of economic growth and development.

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(*) From September 1993 until November 1994 Christopher Lingle held the position of Senior Fellow in the European Studies Programme of the National University of Singapore. He was recently tried and found guilty, *in absentia*, following his commentary in the *International Herald Tribune* where he described tactics of repressive regimes in East Asia, yet named no country nor any government officials. Nonetheless, Singaporean police officers interrogated him in his office as well as his home on two separate occasions and also confiscated research materials. For expressing an informed opinion in an international newspaper, the High Court in Singapore assessed heavy fines against him, and he was charged to pay court costs. A civil lawsuit filed by former Prime Minister, Mr. Lee Kuan Yew is pending. This case has been widely discussed in the American and international news media.

(**) Christopher Lingle, Ph D. Adjunct Professor of Economics Georgia State University

Introduction

During the 1980's, remarkable changes occurred to define a completely new and more widely integrated global trading order. These developments were not out of the design of any politicians nor technocrats. Instead, what might be called a "New World Economic Order" (NWEO) was the evolutionary outcome of a complex set of events, reactions and the beneficial effect of established international institutions. The NWEO is based upon a new set of ground rules that provided opportunities for a whole new group of economic success stories to have emerged.

During the first round of the new global competition, the dynamic East Asian economies turned in impressive economic performance (Chowdhuri and Islam, 1993; World Bank, 1993). While their success is well documented, there is an ongoing debate over the nature of the development pattern that revolves around the role of government. Another issue in the debate is the nature of the political regime that implicitly questions the salient features of political freedom as a necessary springboard for economic prosperity. Many of the terms of this debate arise out of interest in discovering whether there are generalizable conditions that can serve as models for other developing countries.¹

Yet all of this discussion is looking backward. In order to consolidate recent gains and to ensure continued economic success, it is necessary to look to the future. Clearly in the previous round of a global competition, East Asian countries were winners. Numerous studies point to the various shared and unique elements exhibited by Hong Kong, Indonesia, Malaysia, Singapore, South Korea, Taiwan and Thailand. Nonetheless, perhaps the greatest success story of East Asia, Japan, has already stumbled. Cracks are appearing in the armor of this well-oiled industrial and technical powerhouse. All of the stock markets in Southeast Asia have experienced sharp declines in the first quarter of 1994, eliminating most of the impressive gains in these emerging markets during 1993.

Before projecting into the future, one must search for indicators from the past. There are several conditions that link Japan's rise and prospective decline with the high-powered performance of the "tigers" and "dragons" in the neighborhood. The interdependency of the fortunes of this region shall only be enhanced by the prospective dominance of the Chinese economy.

In the end, as identified here, future economic development shall be dependent upon an appropriate set of arrangements that shall underpin success in the next rounds of global competition. Should the present leaders of Southeast Asian countries fail to anticipate the demands of the next round, their success stories shall be reduced from material reality to nostalgic legend.

The "New World Economic Order" as defined here involves a wide-reaching set of conditions that impose a sort of economic rationality driven by principles of free trade. This rationality is the result of a convergence of economic policy initiatives, changing political fortunes and technological changes. Thus, events in the 1980's set the stage for a universal trend towards economic liberalization. Unlike at any time in world history, the momentum to liberalize trade truly has a global dimension. By the beginning of the 1990's, economic policy reforms and the processes of de-regulation and privatization had begun to define this "New World Economic Order". In this section we shall examine various aspects of the NWEO. The first step is to identify the explicit arrangements that are necessary elements to the development of this new order. The next step is to trace the implications for patterns of development and the implementation of economic policies.

Preconditions for the NWEO

The underpinnings of the NWEO are many in number and diffuse in content. However, it is arguable that theoretical arguments about the beneficial consequences of free trade have set the intellectual tenor for what has evolved. While the selection is unavoidably arbitrary, the analysis

shall begin with the establishment of the post-war trans-national institutional troika of the World Bank, the IMF and GATT. These institutions have certainly facilitated the transitional developments of many of the world economies. Benefits accrued not only to the war-ravaged developed economies as was their initial concern, but also to developing economies, many of which were set adrift from their colonial moorings.

Features of the NWEO

Capital markets are perhaps the most important feature of this internationalization process associated with the NWEO. Globalized capital markets now involve a flow of “quicksilver capital” that moves around and through geographical borders in defiance of political boundaries.

The process of the extensive globalization of markets, financial and otherwise, can be traced to the worldwide response to the liberalization of London’s financial markets in 1987. Subsequently, international capital flows have increasingly become a substitute for trade flows. Producers can readily defeat protectionist barriers by simply transferring capital into the country that imposes the barriers.²

Implications of the NWEO

The political impetus behind the liberalization of world markets has been based upon the realization of political leaders that their survival depends heavily upon economic growth, accompanied by a reasonable distribution of the gains from such growth. In turn, it has become increasingly clear that economic growth requires a policy path that opens up domestic economies to international markets. Countries with “capital friendly” institutions shall attract the attention of itinerant investors, leading to either foreign direct investment, equity investments or lending.

An important aspect of this new international trading regime is that it reduces the impact of interventionist and protectionist policies. As suggested above, capital can now simply seep around protectionist barriers. The relocation of productive activities, as a form of “flight capital,” arises both from push and pull factors. Push factors involve the attempts by capital owners to escape irrational domestic policies. Pull factors arise more attractive profit opportunities. The elements that are likely to make relocation more attractive are lower production costs, reduced risks and more flexibility in management decisions. “Foreign” capital can be readily endogenized; foreign producers readily become “domestic” producers, employing localized labor.

An understanding the operation of the NWEO provides a partial resolution to the ongoing debate over the appropriate role of the state in the economic development process. On one hand, a neoclassical approach predicts that governments that pursue “good” economic policies can boost economic growth and development. On the other hand, a statist approach sees a central role for governments in guiding economic development. This debate is relevant to a variety of post-authoritarian regimes whether in East Europe, Africa, Asia or Latin America.

However, it is becoming increasingly apparent that governments can no longer delude their citizens in claiming that their policies can either protect or promote jobs. This is not to suggest that there are no longer efficiency losses arising out of interventionist-protectionist. However, these losses fall upon the least mobile resource, labor, and only in the short run. The game is up; citizens shall be able to see through government policies which harm them doubly. While as consumers, they are forced to pay higher prices in protected markets; as laborers, they shall face higher prospects for being unemployed. Protectionism simply destroys domestic jobs by chasing away capital. Clearly there is widespread confusion, fear and anger among citizens in low-growth, high-unemployment Western economies.

With the discrediting of socialism, the real divisions of economic life are being brought into sharper focus. Economic life is not a struggle between the proletariat and capitalist nor between

the North and the South. The struggle is between those whose fortunes depends upon ever-expanding government programs and the rest of us who must pay for them. Bureaucrats, politicians and special interest groups seek to exploit the productive members of the community through rules, regulations and taxes that promote their own position. As voters' awareness of the nature of this struggle, they can be expected to punish politicians who make false promises of "creating jobs" and "growing the economy". The NWEО is likely to change the functioning of representative democracies due to a reduced capacity for passage of interventionist legislation that normally designed to benefit special interest groups.

Under the NWEО, interventionist government policies are reduced, at least in the long term, to populist rhetoric. These possibilities represent a step towards a true form of international democracy where consumers express their (material and other) values through participation in an increasingly global marketplace. It might be argued that democracy works best when the values of an increasingly large percentage of participants are taken into account. Market transactions result from unanimous accord from buyer and seller, producer and consumer. In this case, then the unanimous agreements arising out of market transactions represent an improvement over majoritarian decision rules. While it may be the case that individuals not directly involved by a market transaction may be affected, ill-conceived public policies and bureaucratic inertia impose costs on citizens that are more pervasive and are enforced by governments' monopoly on the use legal use of violence.. However, facilitation of the international flow of factors of production and commodities has diminished the ability of government officials to impose policies that lead to inefficiency and price distortions.

A further consequence of the NWEО is that formalized agreements for regional economic integration (Free Trade Areas—ASEAN, NAFTA, EFTA; and common markets—EC) or those which broaden global trade (GATT) are becoming increasingly irrelevant. However, a new perspective is required to evaluate these institutions. In the first instance, a great deal of good will is lost in conflict over reaching final agreements on these institutions. International relations were placed under considerable stress in the negotiations over the Uruguay Round of GATT. Domestic political capital is often spent and divisions opened up as they have been in the USA and Canada concerning the implementation of NAFTA. Once politicians and diplomats comprehend the ramifications of the NWEО, they shall be able to direct their attention to other issues.

Thus, comparative and competitive advantage in the 1990's shall depend upon institutional arrangements that provide opportunities for profitable operations. In the end, those countries with the greatest predisposition for flexible and responsive institutions shall be able to develop and to maintain comparative advantage in the New World Economic Order.

East and Central Europe in the NWEО

East and Central European (ECE) countries are in a good position to develop a new set of institutions that may allow them to displace East and Southeast Asia as a net recipient of direct investments and portfolio capital. First, many countries in ECE are moving ahead in their transition program with a "clean slate" having unburdened themselves immediately of the artificially-imposed communist institutions. Currently, those countries that have undertaken radical steps towards transformation of their economies already exhibit encouraging economic success. Others are likely to imitate successful policy regimes and to avoid failures. Second, much of the available labor in ECE is highly skilled (surplus) with high productivity and low real wages. Eventually ECE countries shall have ready access to mature (import-oriented) markets once their applications for European Union membership are approved. For Americans and West Europeans, investment in ECE involves reconciliation of fewer cultural differences than found in other regions. Finally, Europeans tend to display more of the necessary qualities of a true entrepreneurial class. It is not enough to act upon opportunities to "buy low, sell high". Real entrepreneurs tend to exhibit an iconoclastic willingness to challenge the status quo, including questioning of gov-

ernmental authority. Embodied in this entrepreneurial spirit is an unrelenting sense of individualism. Since these conditions and characteristics are mostly absent in an Asian setting, East and Central European countries have a unique opportunity to set off upon their own miracle path of economic growth and development. A distinct advantage for ECE is what might be a "reverse brain-drain" where émigrés and/or their offspring return with well-developed skills applicable to the transition process. A good mesh is likely to occur whereby highly capable mid and upper level managers are transplanted to take over groups of skilled workers with shared cultural values. What is required first is that the institutional structure provides the sort of incentive structure to support socially-productive activities.

East European Choices for Economic Transition

There is an apparent lack of consensus over the best course for economic policy responses for the East and Central European transition to becoming market economies. Most observers find themselves in one of two opposing camps that are often summarized as the accelerationist and gradualist approaches. Supporters of the accelerationist approach accept a need for rapid institutional changes. Gradualists promote a step-by-step process.

Any discussion of the transition alternatives must begin with an understanding that many of the observed economic problems are unavoidable and are hangover effects of communism. Communism's institutional framework has bequeathed numerous inefficiencies and market irrationalities which are observed during the transition process. Disregard for this aspect of post-communist transition can lead to a confusion of symptoms with cures. As a consequence, the selection and interpretation of actual transition policies may not clearly identify the nature of the approach to systemic transformation. Suggestions that a supposed "vicious cycle" of under-development and chaos (shrinking output and rapidly rising prices) arises from choice of policies ignore the pre-conditions determined by communist institutions. It is also necessary to differentiate between "reform" and "transformation". Economic transformation involves a radical and fundamental restructuring, whereas economic reform generally involves little more than tinkering with established institutions.

The accelerationist strategy departs from a commitment to real and rapid transformation. Economic as well as political rationale can be offered to support this approach. First, the economic effects of rapid and sweeping implementation can convey political payoffs. Bunching the elements of the transition package at the outset can involve a sort of "economy of scale" upon the structural incentive adjustments within both the polity and the economy. In such situations, the unavoidable costs of economic rationalization can be offset by some immediate benefits. Implementation of a rational pricing system and monetization of the economy is an important step. However, the hidden, non-price costs of socialism are traded off for obvious costs which may be mistakenly blamed upon the transition program. The slower is the transition, the more distant are the recollections and disadvantages of queuing due to shortages, the lowest common denominator of quality and the lack of imports. Voters tend to be short-sighted. The sooner the worst of the adjustments are experienced, the greater shall be the political payoffs to elected officials. Similarly, rapid implementation can also limit rent seeking by interest groups to form in order who seek protections from more painful, yet necessary, reorganization.

Gradualists pursue a more reform-oriented strategy, putting off the significant institutional changes into the future. A major problem of this piece-meal approach is that obscures the source of distortions. Thus, as suggested before many observers shall be inclined to confuse symptoms of the hangover with the prescription for the cure.

One of the common arguments set forward by gradualists is that the conditioning of socialism leaves the afflicted populations ill-prepared to confront the chilling conditions of capitalism. A counterpoint to these claims is that Chinese peasants, despite their complete

lack of experience with the market, adjusted with great alacrity to the opening of agricultural markets and the quasi-property rights that were granted.

Even if one accepted that the theoretical arguments are inconclusive, the actual results of transition provide interesting results. Beginning with an evaluation by region, the European experience reveals consistent evidence that supports the accelerationist approach. In the Big Bang corner, Estonia and Poland are competing for the highest rates of economic growth in all of Europe. The Czech Republic, under the capable direction of Vaclav Klaus, chases the economic growth leaders and has unemployment of 3.5%. Hungary is attracting massive amounts of foreign capital. Stock exchanges in Prague, Warsaw and Budapest are undergoing a boom, sparked in part by share shortages in these markets.

Despite suggestions to the contrary, Russia provides an archetypal example of the problems associated with gradualist transition policies. Its leaders have followed an archetypal gradualist policy. Gorbachev (a "reform" communist), and most of the so-called parliament which he bequeathed to Yeltsin (a "reformed" communist), was rigidly opposed to private property ownership. Russia's economy continues to be burdened by the pre-modern constructs of a Soviet-style system. Much of Russia's economy, like China's, continues to require state subsidies for survival. Ministries continue to control resources, having changes their designation but not their functions. Similarly, Latvia and Lithuania, Estonia's Baltic neighbors, suffer from the chronic new form of "stagflation" which is common to other countries which have undertaken gradualist policies. The Ukraine and Slovakia have resisted marketization and face dire economic and political circumstances. Although the issue may seem confused by civil war and ethnic warfare, Georgia and Yugoslavia can be seen as cases of gradualism.

In the Asia-Pacific region, New Zealand is the most notable success of Big Bang policies having shaken off the interventionist stranglehold imposed by a socialist Labor government. It is also arguable that China's early successes in the marketization of agriculture were, could be interpreted as a "mini-Big Bang", or at least perhaps a "big push".

There has been a presumed superiority of the slow and gradual transition strategy, as developed in China, Laos and Vietnam. However, it should be made clear that there is no clear geographical distinction, whereby some Asian countries have pursued a gradual reform strategy and East European countries a Big Bang strategy. Both strategies have been applied in Asia as well as Europe. The record in Europe provides strong support for the fast track strategy. Poland, the Czech Republic and Hungary are in the forefront of the transition process having chosen Big Bang solutions. The Ukraine, Slovakia and Romania are experiencing enormous economic problems which threaten to get out of hand. Gradualist reforms allow for the contradictions of failed institutions to endure and to pose problematic long term economic consequences.

In comparing results of transition policies the differences in economic structures need to be considered. East European economies have progressed beyond initial industrialization stages, while most Asian economies have not. Many Asian economies are dominated by small-scale "family-based" agriculture and industry.

The countries of ECE began their transition under substantially different conditions. Communist economic policy in ECE was centered around the principle of large-scale industries. COMECON required that each member country should specialize in some branch of industry and then trade with other members. The result was the build-up of vast state-owned enterprises. Transformation from this industrial structure would obviously require different strategies from economies dominated by small-scale enterprises.

For example, Poland, the Czech Republic and Hungary undertook a massive sell-off of state enterprises. Divestment of state-owned properties in Eastern Germany continues apace under the

steady hand of the Treuhandstadt. This was seen as a critical element to reduce the economic drag from the subsidies required for loss-making state firms. The general idea is to expedite development of the new economy, with swift moves to dismantle the old structures. Delays would mean that any new sources of taxes would be diverted by inefficient state-owned firms. This would threaten the viability of the entire transition project, as is becoming so evident in China. In all events, rapid transformation forces the hidden unemployment to the surface while gradualism provides a veil over the extent of underemployed workers. Opponents of the accelerationist approach seem unable to understand that high rates of unemployment and sagging production are residual elements of the failures of authoritarian socialism.

The exportability of Asian gradualist reforms raises other questions. The post-communist European transitions began with democratization. Meanwhile, gradualist reformers in China, Vietnam and Laos continue to operate within authoritarian regimes. They impose controls on their economies which would be unacceptable under a democratic system. Democracies tend to allow citizens to select and to pursue their own life purposes within reasonably wide bounds. Entrepreneurs wishing to undertake new enterprises under democratic governments are less likely to find their activities restricted or banned. Democratization of socialist economies demands that private property rights be initiated and protected. Governments shall also have to give up control over resources and abandon the irrational tendency to hoard labor. Successful transformation in ECE, as elsewhere, shall require rapid withdrawal of the state sector from their economies. Reluctance to reduce state intervention will lessen future economic growth prospects which depends upon a viable private sector. Extensive intervention of governments tends to crowd out private initiatives which can serve as the engine of future economic growth.

Economic Growth and Political Freedom

Economic growth is often cited as a basis for development of political reform. The mechanism for such developments is described, at least in a Western context, is an emergent middle class. As is the case for other "normal economic goods", increased incomes lead individuals to increase the demand for political freedom. However, there are various conditions which underpinned the emergence of the middle class in the West. In the first instance, institutional structures enabled individualism and individualistic expression to serve as a basis for an entrepreneur-driven market economy. These institutions were consistent with the concept of individual rights and freedom as crucial supports for the political viability of private property ownership. In turn, for individual control over capital and other factors of production to be effective minimal restrictions must be placed upon government policy.

It would seem an exaggeration to suggest that the current socio-economic and political institutions in China would support an instantaneous appearance of a middle class. manifestation of property rights in China shall give rise to an embryonic middle class. For example, resale rights on landed property are tightly circumscribed. The extent of restrictions placed upon participants in these transactions far exceed those encountered in most market economies. The bid-and-offer activity which defines market activity is almost totally absent since property prices are set unilaterally by the government. In this setting, negotiations are virtually non-existent. Peasants face similar restrictions whereby agricultural land that consists of leaseholds which are non-transferable.

Without removal of restrictions on private ownership and control over capital, it is difficult to envision the appearance of a vibrant and politically independent middle class. Chinese law imposes substantial obstructions against entrepreneurial independence due to continued bureaucratic control of most resource and capital markets.

In all events, many of China's "middle class" actually owe their success to a close relationship with the Communist Party. Similarly, they often operate within a netherworld of corrupt business practices. Extensive regulation of economic life, dependency upon government largesse and absence of a viable commercial code invites pessimism in terms of expectations of a Chinese

bourgeoisie capable of exercising political influence over a repressive regime. These difficulties are only compounded by the traditional Chinese culture which is based upon Confucian principles.

Growth and Entrepreneurial-Based Market Economies

This section explores the impact of Confucian culture upon patterns of and prospects for economic advancement in China and other parts of Confucian East Asia. While the observed Confucianist regimes exhibit pursue goals that are ostensibly communitarian, there is an attempt to promote the role of the individual as an entrepreneur. An unstable equilibrium should be expected to emerge since entrepreneurs are conspicuously individualistic, contrarian and generally defiant of established orders.

Economic Development in Confucian East Asia

Economic performance in China and selected other economies in East Asia represents one of the great economic success stories of history (World Bank, 1993; Chowdhuri and Islam, 1993). Of these major new global players, Hong Kong (under British colonial rule until 1997) and the countries of Korea, Singapore and Taiwan are linked historically through Confucianism. This entrenched value system has had an important impact upon the development of institutions in these regions which in turn influence current economic performance. Finally, some projections are offered on the future institutional change within this cultural setting.

The process of economic and social advancement in Confucianist cultures is constrained by the paradox described above. On one hand, governments have sought to legitimate their exercise of a degree of authoritarian power (often coincidental with a substantial degree of social harmony) by appealing to Confucian tenets of respect for authority and adherence to long-standing traditions.³ In this context, the individual is expected to put society above self. Individual interests are to be subordinated to the interests of the community (or at least those identified by the ruling political party). On the other hand, these same governments also recognize that their legitimacy depends upon “performance” criteria, especially in terms of economic progress. The links between the delivery of economic performance as a means for community advancement is well understood.

In this context, individual action in pursuit of individually-chosen, subjective goals will often appear to be in conflict or to be distinct from others in the community. Contrary to the Confucian precepts, entrepreneurs seek their own identity and view their actions as serving their own ends rather than to serve as a means for others in the community. Logic suggests that these inherent contradictions constitutes an unstable equilibrium which requires constant attention and an unerring, steady set of hands.⁴ Otherwise these incongruous forces become in open conflict with some of the other aims of governments in a Confucian context, including a threat to their continuity. Like other activities that require micro-managing and continual fine-tuning, maintenance of this balance is likely to be very difficult.

Characteristics of “Real” Entrepreneurs

Entrepreneurial activity involves behavioral patterns reflecting a specific and unique manifestation of human actions. Departing from the economist’s model of individual behavior, human action and choices are seen to be based upon “purposive behavior”. This view depicts a calculation process whereby individuals select courses of action which are consistent with their uniquely defined set of life purposes. In this sense, we discard a narrow definition of “self-interest”. This model of purposive behavior can be seen to have broad implications. Human choices are seen to be motivated by intentions to confer benefits beyond the self, to the family, extended family, the

community or a nation. These choices of action influence producers and/or consumers, and can be driven by a wide range of personal aims. Apparently selfless altruism and unbridled greed are both consistent with this description. Likewise, the intent of purposive behavior may be toward intellectual or cultural betterment and is not limited to a quest for mere material gain. In all events, the essential element in this broad model of purposive behavior is that observed actions arise out of the process of choice.

Thus, entrepreneurs are persons who consciously choose to behave in a certain way. In a commercial setting, this might involve a tendency to “buy low and sell high” within an open, competitive environment. Consistent success with this mode of conduct requires an alertness to profit opportunities and an understanding of the competition. A successful entrepreneur identifies opportunities to combine resources in a new or unique manner to provide new or improved market offerings. The measure of entrepreneurial success is determined by the reaction of the community at large. Offers are made to resource owners who evaluate them according to their other alternatives, what economists call opportunity costs. Similarly, consumers compare the price of the good or service offered against alternative purchases. If the selling price is higher than the costs of provision, then a profit is earned. In all these market transactions, agreements are voluntary and thus involve unanimity such that all involved parties deem themselves to have been made better off. Here we see that entrepreneurs have a great potential in serving the community by providing increases in the well-being of those directly involved in a market transaction.

Description of the community role of the entrepreneur must begin with an understanding of the element of choice. Identification of the entrepreneur arises out of an evaluation of the outcomes of choice. Following counter-intuitive reasoning derived from an admittedly consequentialist logic, we determine that outcomes are more important than intentions. Successful entrepreneurial actions are those which generate public benefits even if driven by the most egoistical motivations. Similarly, those actions which are announced to be based upon an intent of improving the position of most of the community, must also be judged by results.

Due to this condition, we shall exclude political or bureaucratic actions from consideration as being “entrepreneurial”. Agents operating in the polity, especially within a framework of representative democracy, face a set of incentives which induce them to implement policy which tends to serve narrow or special interests. It is quite clear a basic requirement to be (re)elected, politicians is to attract a majority of the votes cast. This requirement (“vote motive”) allows well-organized interests to be able to impose a heavier influence on political judgments since they can deliver blocs of votes and financial support for candidates. This situation undermines the concept of “one-person, one-vote” which is seen as a defining element of representative democracy. Likewise, bureaucrats can be expected to implement or to pursue policies consistent with their own personal life purposes. Most of these ends require enlarged budgets that are raised at the expense of taxpayers. Under representative democracy, public policies are more likely to reflect the preferences of special interest groups or to confer benefits to bureaucrats and politicians rather than to serve the ends of the broader community. Unlike in a market context, where transactions are decided by unanimity, democracy normally depends upon satisfying some majority. Reliance upon political judgments (majority preferences) is normally inferior to market outcomes (unanimous preferences) since the former provides opportunities for one group to exploit others.

Individual actions taken by politicians and bureaucrats are not entrepreneurial in the pure sense of the term. Policy actions which reduce community welfare, are often the result of “rent seeking” rather than the socially productive outcomes of “profit seeking” by the entrepreneur.⁵ Rent seeking behavior involves diversion of resources from productive activities (e.g. research and development, worker training) toward “non-productive” activities (e.g. lobbying). These diversions represent “waste” and reduce well-being since they do not add to the stock of wealth in a community. Expenditures to lobby politicians or bureaucrats are usually designed to seek implementation of policy for obstruction of competition or secure monopoly profits (rents). The rest

of the community is made worse off since those funds might have been used to produce more or better goods. Instead, there are fewer goods available and these are likely to be had at higher prices due to restraints upon competition. Politicians and bureaucrats are not necessarily rent seekers, but they are able to control the creation and distribution of the sort of monopoly returns. The creation and control of these rents establishes an incentive structure that has a broad influence on economic decisions.

Following the above arguments, “true” entrepreneurs are not rent seekers, and so it follows that those businesspersons who operate as rent seekers are not real entrepreneurs. Entrepreneurs seek risks and undertake initiatives. Rent seekers attempt to divert public policy to reduce competition. Politicians and bureaucrats react to a totally different incentive structure. Bureaucrats are rewarded for implementing and following rules. Entrepreneurs have a relatively low threshold for following rigid rules. It is true that politicians take some sorts of “risks”, since the selection of policies may influence their (re)election. However, if they make mistakes the monetary costs shall be borne by taxpayers. When an entrepreneur fails, only those who choose to share the risks incur costs. Unlike the political setting where costs of failure are widely dispersed over the entire political constituency whose participation is often involuntary, the costs of failure in the market are limited by self-selection of risk-takers.

There might be a special class of persons who undertake business which follows a pattern which fits the agenda of the political power structure. As elsewhere, it is necessary to promote economic growth in order to legitimate continued political dominance of the ruling party. However, in the authoritarian Confucian context tight rein must be kept so that these very successes are not the source of a challenge to political authority. Those individuals whose economic success is outside of the government-controlled framework shall have less loyalty to the powers-that-be and will be more likely to view government agencies as obstructive bureaucrats.

At least two possible solutions come to mind to limit this source of challenge to authority. First, all domestic entrepreneurs could be co-opted into the government agenda. However, this approach would have little success since real entrepreneurs exhibit erratic behavior, are unpredictable, and they tend to dislike rigid rule structures. Another possibility is to use political rather than economic judgments to determine who has access to bid on contracts or to decide upon whom undertakes certain business activities. In this sense, political support could be generated since those select individuals would owe their fortunes, and thus their loyalties, to the government. At the same time, support for the government among small traders could be encouraged by facilitating or by eliminating obstructions to their activities. Another means of control would be to limit the larger undertakings to foreign entrepreneurs, in other words to encourage foreign direct investment.

“Entrepreneurs” and Opportunities in East Asia and Europe

Volatility in Asian emerging markets in the beginning of 1994 provides a strong signal of a wider trend. The simple fact is that much of the glamour and high returns are rapidly disappearing in East Asia, inducing international investors to look elsewhere for higher returns. As market fundamentals have shifted in favor of other regions, the economies of ECE are poised to become the focus of new attention.⁶ Many of the ECE economies are “diamonds in the rough”. The following remarks point to a variety of elements which point to specific elements of the shift of comparative advantage from Southeast Asia toward East and Central Europe.

Advantages of Investing in East and Central Europe

1. *“Clean slate” of institutions during their transformation process.* The political leaders can be expected to avoid failures by imitating development models with proven track records.

2. *Highly skilled (surplus) labor.* ECE has a particularly promising combination of high productivity and relatively low real wages.
3. *More ready geographic access to mature (import-oriented) markets.* The markets of North America and Western Europe have institutional arrangements to slot in the developing economies of Latin America and ECE, respectively.
4. *Fewer cultural differences for Western investors to reconcile than exist in other areas.* Both ECE and Latin America possess a distinct advantage by sharing European traditions and historical links.
5. *Essential qualities of "true" entrepreneurs are more consistent with Western political and cultural institutions.* Entrepreneurs tend to be iconoclastic in nature, exhibit a willingness to challenge the status quo, including government authority. Most Western institutions are premised upon and often offer rewards for individualistic behavior that leads to a readiness to be risk takers.
6. *Benefits from reverse brain drain.* The ECE countries are presently recipients of net inflow of émigrés with well-developed management/financial skills and with established business contacts outside the region. As a consequence, they have a readily available quantity of skilled managers with similar cultural and ethnic background to guide highly skilled workforce.
7. *Disposition to openness and ready access to economic data.* It can be expected that there will be a continued distrust of control over economic data and other aspects of civil society reminiscent of the communist era.
8. *Success depends upon market responses.* Merit and the capacity to meet requirements of consumers in a competitive market are principal avenues for success. Positive-sum outcomes are possible where consumers are better off in that anguished competitors can seek alternative openings in other markets.
9. *Investment opportunities from privatization.* Many state-owned enterprises in Latin American and Europe continue to be available for sale.

Disadvantages of Investment in Southeast Asia

1. *Commitment to present political order.* Political hubris and authoritarian tendencies are likely to lead to a static set of political arrangements along with an inflexibility and lack of eagerness to adapt to new institutions. The certainties arising prevalence of one-party dominance of the polity are offset by the rigidity and reluctance to change.
2. *Labor market shortages.* Many Asian economies tend to suffer from a lack of both skilled labor and managers. As a consequence, real wages can be expected to rise causing a shift in comparative advantage.
3. *High likelihood of trade frictions and disputes.* Absence of reciprocal trade practices due to instinctive tendency to exercise control over economic and political matters can be expected to lead to disagreements over commercial practices.
4. *Cultural differences.* Confucian values, hierarchical governance, traditional institutions and authoritarian tendencies complicate discussion of commercial and human rights issues.
5. *Tendency for governments to set conditions for commercial success.* In many instances, commercial activity tends to be determined by access to special arrangements (*guanxi*) and crony capitalism. Where this exists there is likely to be endemic corruption.
6. *Problems arising from continued brain drain.* The absence of individual freedom induces free thinkers to seek free environment.

7. *Tendency to restrict access to economic data.* Official control over access to economic statistics impedes meaningful debate over the future of economic development.

8. *Success may depend upon collusive arrangements with government officials.* Monopoly privileges and exclusive, special treatment close off opportunities to other producers. These zero-sum games tend to drive up costs and prices.

9. *Little effort to privatize in East Asia.* Fewer investment opportunities since privatization schemes are not well advanced in the region.

Conclusion

An apparent consensus has formed around the superiority of an “Asian Model” of economic development. This conventional wisdom is based upon partial information and incomplete analysis. While the material successes of rapid development in Southeast Asia cannot be denied, there are strong indicators that this success shall soon face daunting challenges. This is especially problematic for the authoritarian regimes in the region which shall have to face up to choices which threaten their continued dominance. Refusal to adapt to the constantly changing realities associated with the NWEO shall lead to decreased rates of economic growth and a weakening of the principal source of political legitimacy. However, continued relaxation of government controls over their respective economies shall also threaten their dominance. The choice is double-edged, viz. authoritarian regimes must either adapt or die, yet if they do adapt their lifespan shall also be limited.

Governments in East and Central Europe and elsewhere should understand the nature of the rise and prospective decline of the “Asian Model”. In the end, comparative advantages shall shift towards those countries with responsive institutions and economic arrangements which are attractive to globalized capital. Despite its potent political implications, the most important issue to address is increased labor market flexibility.

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End Notes

¹ The search for the evidence of and attempts to describe elements of an “Asian Model” depart from a narrow perspective on Asia. The most conspicuous lacuna in the analysis is that the importance of South Asia is overlooked. In other words, the concept of an “Asian Model” is consciously or unconsciously limited to Southeast or East Asia.

² This substitution is slightly imperfect as they almost certainly raise transaction costs by less than those imposed by economic protectionist barriers.

³ Confucianist values include discipline, keeping peace with neighbors, society above self, reverence for scholarship, as well as loyalty and respect for authority. This latter injunction involves a variety of hierarchical relationships, including between generations (filial piety) and between ruler and the ruled (loyalty to the state).

⁴ Of course, it is possible to resolve this paradox by suggesting that ruling parties simply attempt to bind Eastern values into a national ideology which they in turn direct for their own purposes. In this setting, real entrepreneurs are replaced by those who are close to the government officials.

⁵ The concept of rent seeking, though developed by others, is an original contribution of Tullock (1967) and is associated with the Public Choice School of economics.

⁶ Aside from ECE economies, Latin America and India provide increasingly attractive opportunities for investments.