

Chapter 2

Balancing Growth and Social Policies

Coping with problems generated by growth

All successful economies in East Asia followed a policy orientation which contains two main components: *growth policies* and *social policies*. Growth policies include measures that stimulate and sustain private-sector dynamism such as the provision of indicative visions, plans and strategies; education and training; technology transfer; infrastructure; supporting industries and SMEs; attracting FDI; saving mobilization, and sectoral supports and subsidies¹. On the other hand, social policies are measures that cope with problems caused by rapid growth such as inequality, pollution, urbanization, traffic, housing, rural-urban migration, asset bubbles, corruption, illegal drugs, materialism, and decline of traditional values. Growth policies are primary and social policies are secondary, in the sense that the latter are needed only when the former are successfully implemented.

Yasusuke Murakami, a Japanese social scientist, stresses the importance of simultaneous execution of growth policies and social policies (which he calls “supplementary policies”) in order to avert the negative aspects of development. As he puts it,

When targeted key industries begin to grow rapidly, people in these and related industries will experience a shift in life style and even in attitude toward life. ... [E]specially in latecomer countries, social structure, including the national psychology, will be impacted strongly by the force of “modernization,” sowing the seeds of social tension. Such tension typically arises from a widening gap in income and life style between urban and rural populations. Equally notable is the formation of mega-cities and surrounding slums which are often seen in Latin America and Asia. Failure to alleviate social tension under these circumstances can lead to political conflict, which ultimately stymies developmentalism itself. (Murakami, 1994, p.192, English translation)

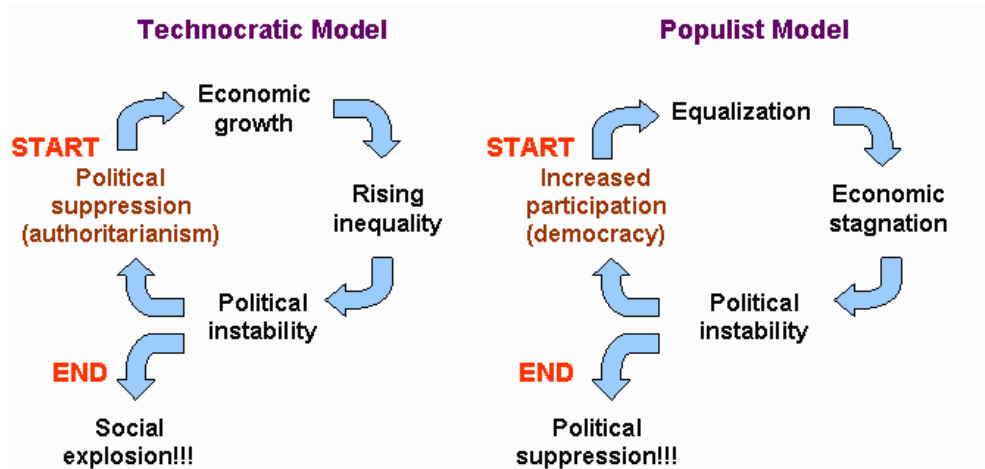
Once rapid growth begins, social transformation is inevitable. It permeates all aspects of social life, including life style, psychology, attitude, work, entertainment, family relations, community, human mobility, environment, culture, and politics. Development cannot be sustained unless both growth policies and social policies are conducted in proper balance. The required contents of these policies differ from one country to another, and they must be designed and implemented to suit local needs. In East Asia, only those countries that managed to do this more or less competently have achieved economic miracles.

Observing the dismal situation in Latin America in the 1960s and 70s, where ruthless dictators and incompetent populism alternated, Huntington and Nelson (1976) concluded that chaos would be the inevitable end result no matter how the country started the development process (Figure 2-1). In their *technocratic model*, an authoritarian state with suppressive

¹ Some of the old measures such as tariff protection, import quotas and bans, export subsidies, local content requirement, and foreign currency balancing requirement are now prohibited by WTO. However, many measures that do not violate WTO principles are still available, as listed in the text, and can be mobilized for industrial policy formulation today.

policies initiates growth, which breeds inequality and raises social tension. To cope with this situation, the regime introduces even more suppression. After a few rounds of this, discontent mounts to a critical level, people take to the street, and society explodes. Alternatively, in their *populist model*, a democratic state which permits broad participation is initially installed. The government distributes available economic benefits among interest groups but does not succeed in increasing GDP. Economic stagnation leads to dissatisfaction and the regime is eventually thrown out by a military coup. Hence the conclusion that there is no easy way to generate economic growth while maintaining political stability.

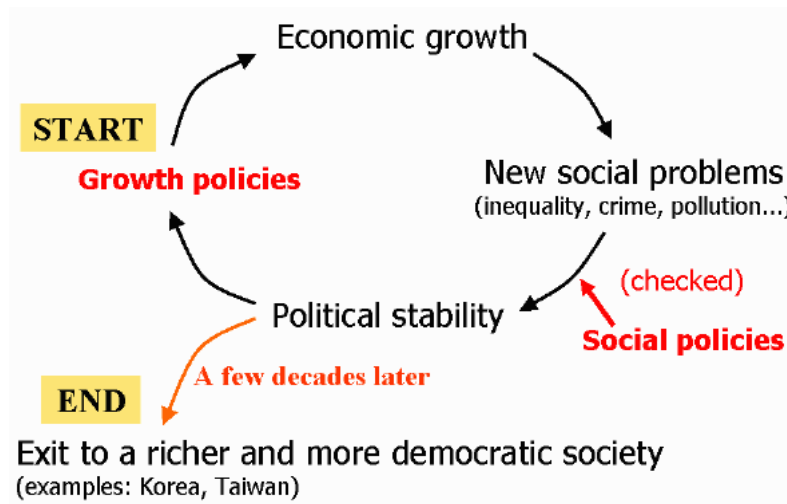
Fig. 2-1 No Easy Choice?



Source: Compiled from Huntington and Nelson (1976).

Using this framework, what East Asia's successful economies did can be portrayed as the revised technocratic model where rising inequality and other growth-generated problems were ameliorated through social policies (Figure 2-2). With this policy package, crisis is averted and the virtuous circle of economic growth and political stability are maintained for a few decades until the society changes from within (see below). This policy mix was the East Asian answer to the Latin American puzzle presented by Huntington and Nelson. The policy pattern is clear but, of course, the question is how adeptly a country can actually execute it.

Figure 2-2 The Policy Mix for Successful Development



Indonesia and the Philippines are two countries that participate in the East Asian production network while continuing to struggle to maintain economic growth and social stability. Their problems come mainly from politics and social structure that prevent effective implementation of growth and social policies. Since September 2006 with the ousting of Prime Minister Thaksin Shinawatra, Thailand has also faced a mini political crisis. Behind it is the problem of persistent and structural income discrepancy between Bangkok and rural areas.

Successful development in Vietnam also hinges on the balanced execution of growth and social policies in the years to come. In the current social context of Vietnam, the following problems arising from high growth deserve special attention:

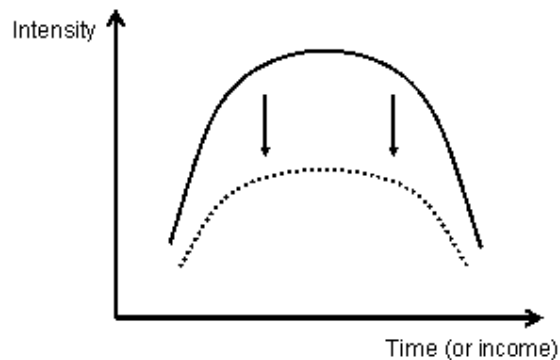
- Alarming traffic congestions and accidents, especially in Hanoi and HCMC, caused by a large number of motorcycles and an increasing number of automobiles which outstrip the speed of transport infrastructure development.
- Health hazard from rapidly deteriorating environment in urban and industrial areas in terms of air, water, and solid waste.
- Accelerating inflation caused by an overheated economy, with most people perceiving that prices are rising much faster than their income.
- Widening income and asset inequalities among population, a large part of which is attributable to land inflation and faster growth of cities relative to rural areas.
- Demographic dynamics such as migration from rural areas to big cities, disappearance of traditional family units, aged and disadvantaged people without protection, and the like, with associated problems in human security, social instability, culture and value, and urban and rural communities.

The phenomenon of the inverted U-curve

In the process of fast and continuous industrialization, many social phenomena tend to follow dynamics of the inverted U-curve when plotted against time or income level (Figure 2-3). Many social problems generated by fast growth often peak as the country reaches a certain income level and decline thereafter. These include environmental damage, traffic congestion

and accidents, corruption, street children, and social evils such as illegal drugs, prostitution, and HIV/AIDS².

Figure 2-3 The Inverted U-curve



In Japan, for instance, deaths by traffic accidents rose sharply from 4,429 persons in 1951 to 16,765 persons in 1970. This was the result of rapid motorization when road safety devices and vehicular safety technology were lacking and people's awareness of traffic safety was low. In 1970, the government passed the Basic Law on Traffic Safety Measures and made traffic safety a top national priority. By 1979, deaths caused by traffic accidents fell to 8,466 persons despite continued increases in the use and ownership of automobiles. Similarly, air and water pollution in Japan worsened significantly in the 1960s. Civil society movements and a series of anti-pollution lawsuits were launched, and the government responded by enacting the Basic Law on Anti-pollution Measures in 1967 and creating the Environment Agency in 1971. Environmental quality in urban areas improved dramatically in the 1970s.

Many of the inverted U-shape can be explained by insufficient investment in technology and infrastructure for preventing deterioration in the early years of industrialization. This neglect occurs because of the attitudes of both policy makers and general public that prioritize growth at the cost of social problems. As living standards rise, however, people gradually move away from myopic and self-centered materialism and turn to broader social concerns.

Some argue that such transition in social preference is natural and low income countries must accept the aggravation of environment, congestion and crimes to obtain faster growth. However, it can generally be shown that the preventive cost is smaller than the cost of fixing damage *ex post*. Moreover, some damage such as deaths or de-forestation is so serious it cannot be remedied at any later expense. People choose the easy way because the preventive cost is frontloaded while the treatment cost is paid by others later.

This is a problem in time scope, and the government should take steps to correct the situation as soon as possible rather than accepting short-sightedness. This is illustrated by pressing down the inverted U-curve in Figure 2-3. Even at low income, a variety of social policies are available under limited financial and human resources. They are necessary to guarantee minimum life quality in a rapidly growing society.

² The inverted U-shape dynamics over inequality is called the *Kuznets Curve* (ch.3). Empirical evidence and possible causes of the Kuznets Curve remain controversial. Other social phenomena which are not necessarily considered bad may also exhibit the inverted U-shape pattern, including rural-urban migration, the use of housemaids, labor export, labor union activities, TV viewership, and so on.

China and Vietnam

China and Vietnam are two countries that are growing fastest in East Asia. They are also socialist countries in systemic transition under one-party rule. They are in the midst of rapid industrialization and social transformation that are expected to last at least for a few decades. Despite differences in size, history, governing style, and the depth of economic planning in the past³, the two countries share basically the same dynamic problems. Their main challenge is to cope effectively with social problems caused by fast growth, while fast growth itself is generated by largely uncontrollable private dynamism rather than good policy.

Unlike Japan and South Korea in the past where the government played an important role in setting concrete industrial goals, upgrading technology and guiding investments, current growth of China and Vietnam is driven mainly by strong private dynamism. In these countries, the government does not orchestrate growth very much other than liberalizing the private sector in pragmatic steps to release private dynamism; preparing infrastructure, energy and raw materials needed for growth; and reforming laws and institutions in response to new challenges. This may already be a great policy achievement but it is much less than what other East Asian governments did in their rapid growth eras⁴. FDI inflows and domestic private investments have been the driving force of structural change, with few selective interventions in the productive sector by the state which are successful. Private industries have flourished where the state receded.

On the question of balancing growth with social issues, Deng Xiaoping's China (1978-1997) clearly prioritized growth over social issues, and brilliantly succeeded in accelerating growth in the 1990s. However, inevitable consequences of sustained fast growth such as inequality, environmental damage, corruption, internal migration, asset bubbles, and so on emerged subsequently to haunt the government. It can be said that the political legitimacy of the Chinese government now hangs critically on solving these social problems rather than accelerating growth further. In fact, growth is already sufficiently high. Moreover, the micro-management of speed and sectoral direction of growth is largely beyond the ability of the Chinese government.

Unlike China, which made a clear shift from growth-first policy to a more balanced policy, Vietnam has long pursued both growth and social objectives with equal weights, and therefore has not made any detectable policy shift in this regard. Poverty alleviation, assistance to ethnic minorities, and regional balance in public investment have always been emphasized. In the future, however, political legitimacy in Vietnam will also depend heavily on the government's ability to execute policies to cope with similar social problems as in China, in addition to sustaining growth.

³ The major differences between China and Vietnam are as follows: (i) traditionally, Chinese people have boasted superb mercantile talent and global trade networks, which Vietnamese people lack; (ii) China went through traumatic Cultural Revolution whereas Vietnam never had such an experience despite post-unification confusion and North-South psychological divide; (iii) Vietnam's ruling style is much more pluralistic and consensual compared with China's top-down decision making; and (iv) the Chinese history of socialist planning and industrial investment was much longer than in Vietnam, where wars prevented consistent execution of economic planning.

⁴ For example, the Korean government played an instrumental role, in close cooperation with *chaebols* and banks, in establishing steel, shipbuilding and automobile industries. In Meiji Japan (1868-1912), the government vigorously promoted import substitution of marine transport, shipbuilding, cotton spinning, steel, locomotives and railroad cars, etc.

The rise of the middle mass

Continued fast growth will surely transform social attitude and structure, which in turn generates demand for new social services and institutions. Vietnam is at a very early stage of such transformation, but future changes are both predictable and inevitable.

In South Korea, which rose from poor agriculture to globally competitive manufacturing in three decades, urbanization, industrialization and modernization proceeded very rapidly. These changes in turn prompted significant upheavals in *political culture* and *social structure* (Nguyen Thi Thanh Huyen, 2004). Political culture refers to the rise of popular attitude which accepts compromise, participation, equality and moderation as a means to reconcile different opinions and arrive at one decision (rather than through threats, violence, bribery or connections). Social structure means a shift in population composition from traditional occupations such as farmers, soldiers, and land owners to new occupations such as office workers, professionals, and small and medium entrepreneurs. The latter group is collectively called the *middle mass*.

Political culture and social structure interact with one another to prepare conditions for new political and social relations suitable for an industrialized society. As the middle mass expands and their demand for more freedom and openness, social amenity and better business conditions rises, the government must respond positively to supply policies, rules and institutions that fit the new reality.

In 1961, 80% of South Koreans were poor farmers. After fifteen years of successful industrialization, workers (over 50%) and the middle mass (about 40%) dominated the social structure in 1985. South Korea made a transition to democracy in 1987, when Roh Tae Woo became the first president elected by popular votes. Socio-economic changes generated by rapid economic growth prepared conditions for political transformation by the late 1980s which was not possible in the 1960s and 70s.

The middle mass in Vietnam is in early formation. Students, office workers, teachers, doctors and business people in big cities, with rising income and new life style, will be the core of Vietnam's middle mass in the future. Their aspiration will be increasingly important in shaping the national policy agenda.