GROWTH AND STABILITY IN SELECTED NEWLY INDUSTRIALIZING AND SOCIALIST ECONOMIES

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1. Introduction

The "postwar" period used to mean the immediate postwar years of confusion and reconstruction. The period of reconstruction was, however, followed by over twenty years of accelerated economic growth, both throughout the world and in Japan, at a rate more than double that of any prewar period. The space of over one-third of a century after the end of World War II, therefore, is no longer a short-term, but a truly long-term period.

From the vantage point of the present, one can now analyze the growth patterns of the developing or the Third World countries from a longer-term perspective, which is not feasible through short-term observations, and one can thus formulate more accurate prognoses for their future.

There was a time when the epithet "developing" was nothing short of a euphemism for those countries characterized by chronic stagnation apparently beyond cure by aid from developed countries. But some of the developing countries have since detached themselves from the rest and jumped rapidly from low development to high growth, reaching the status of NICs – newly industrializing countries – or prospective NICs. The Third World has become an uneven group of nations, which has to be looked upon as a yet-to-be-advanced group of nations in which both stagnation and dynamism exist side by side.

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Having gone through alternations of excessive growth and growth retardation, even the qualified NICs are now forced to plan for stable growth, that is, to try to strike a balance between growth and stability. Of importance to any country in any period, "growth and stability" is a matter of vital concern in the turbulent decades of the 1970s and 1980s.

2. Macroeconomic Balance and Inflationary Growth

The Cases of Korea and Taiwan

While the problem of macroeconomic balance is a first considera tion in any discussion of "growth and stability," it is always the case, *post facto*, that aggregate demand equals aggregate supply. Given a closed system, it is also the case that investment = saving in *ex post* terms. Given an open system inclusive of external trade and the government sector, it is conceivably the case that:

Investment + Current government expenditure + Exports
= Savings + Tax revenue + Imports
ex post, or again
Investment = Savings + Government surplus + Excess imports

Investment here includes public investment, and government surplus and excess imports are restricted to current accounts.

It should not be supposed, however, that all is well simply if these equations stand at equilibrium *ex ante* as well. The equilibrium, if attained beyond full employment income, causes inflation. If the resource-and-energy ceiling is below the full employment ceiling, full employment is unattainable, and there can be inflation side by side even with unemployment. To the left of point A in Figure 1, full employment income is below the resource-energy ceiling level income. So long as this condition is maintained, it is presumably the differences between demand for labor and full employment that will determine changes in wage levels, and in price levels as well. If the reality moves to the right of point A, prices can rise even below full employment and with the unemployment figure in the positive.

When the government sets a high priority on reducing unemploy ment, people tend to have inflationary expectations and to behave speculatively. Under such conditions, actual rates of wage and price changes are not just a function of the unemployment rate but also a function of the anticipated inflation rate, causing the well-known
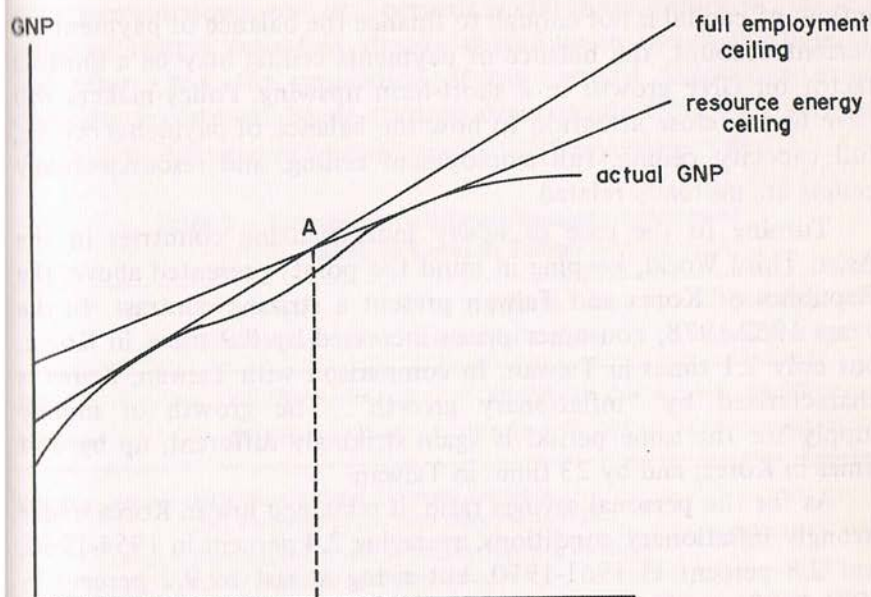
FIGURE 1
FULL EMPLOYMENT CEILING VS. RESOURCE CEILING

Philips Curve to begin to shift upwards, greatly reducing the efficacy of Keynesian aggregate demand policies.

In this way, it is very important to see just at what point the *ex ante* equilibrium between aggregate demand and aggregate supply is attained. Apart from details, it will be of great importance in assessing the given conditions and in selecting policies for implementation to see whether such an equilibrium is attained (1) beyond the full employment point, (2) beyond the full capacity point, (3) beyond the resource-energy ceiling, and how these three are interrelated.

Since the world economy is now located near the resource-energy ceiling, Keynesian aggregate demand policies, focusing on the reduction of unemployment, may naturally bring about inflation. Therefore, a problem arises whether or not inflationary or less inflationary growth will be appropriate. The cases of Korea and Taiwan present very interesting examples in this regard.

Incidentally, these three factors are, of course, not the sole limitations that restrict GNP growth. If, for example, the expected

inflow of capital is not enough to finance the balance of payments in current account, the balance of payments ceiling may be a limiting factor on GNP growth in a short-term upswing. Policy-makers will have to pay close attention to how the balance of payments ceiling, full capacity ceiling, full employment ceiling, and resource-energy ceiling are mutually related.

Turning to the case of newly industrializing countries in the Asian Third World, keeping in mind the points presented above, the Republics of Korea and Taiwan present a striking contrast. In the years 1962-1978, consumer prices increased by 8.9 times in Korea, but only 2.1 times in Taiwan. In comparison with Taiwan, Korea is characterized by "inflationary growth". The growth of money supply for the same period is again strikingly different, up by 154 times in Korea, and by 23 times in Taiwan.

As for the personal savings ratio, it remained low in Korea under strongly inflationary conditions, averaging 2.4 percent in 1954-1960, and 2.8 percent in 1961-1970, but rising at last to 9.2 percent in 1971-1978, as shown in Table 1. Taiwan exhibited over the same period a steady upward trend from 4 percent to 12.4 percent on to 20.2 percent. Inflation rates thus lead to personal savings differentials, which in turn are fed back to inflation rates by way of varying rates of growth of money supply.

Table 1 — Personal Savings Ratio in Korea and Taiwan

	1954-60 annual average	1961-70 annual average	1971-78 annual average
Korea	2.4%	2.8%	9.2%
Taiwan	4.0%	12.4%	20.2%

Sources: Korea — 1951-60; The Bank of Korea, *National Income In Korea*, 1978.
1961-78; Economic Planning Board, *Handbook of Korean Economy*, 1979.
Taiwan — Directorate-General of Budget, *National Income of the Republic of China*, Dec. 1979.

Table 2 shows, for the same time frame, the sum of excess imports of goods and services and net payments abroad of factor income as a ratio of gross domestic investment. Although this ratio in Korea was reduced quite significantly from 69.5 percent to 23.5 percent since the end of the Korean war, Taiwan's performance from

41.1 percent down to −8.2 percent is still more impressive. As the personal savings ratio had already moved up to two-digit figures in and after 1963, the proportion of the external deficit over gross domestic investment began to drop dramatically from 34.7 percent in 1962, to 4.0 percent in 1963 and to −1.2 percent in 1964.

Table 2 — External Deficit/Gross Domestic Investment
Ratio in Korea & Taiwan

	1954-60 annual average	1961-70 annual average	1971-78 annual average
Korea	69.5%	49.2%	23.5%
Taiwan	41.1%	11.9%	−8.2%

Sources: Korea — IMF, *International Financial Statistics;*
UN, *Yearbook of National Account Statistics.*

Taiwan — Directorate-General of Budget, *National Income of the Republic of China,* Dec. 1979.

It is noteworthy, to say the least, that the personal savings ratio became higher in relative terms while dependence on the external deficit was correspondingly reduced in Taiwan which followed the path of non-inflationary growth.

3. Asian NICs and Investment Cycle

NICs, Korea in particular, are said to be in economic difficulties. Korea, which has been cited until recently as an exemplary case of rapid growth, has suddenly begun to go downhill. The rate of growth of real GNP and of mining and manufacturing output actually turned negative in 1980 (in percent):

	1976	1977	1978	1979	1980
Real GNP	15.1	10.0	11.6	6.4	−5.7
MM Output	29.8	19.9	22.9	11.7	−1.7

The sudden shift may be analyzed from various points of view.

First, a measure of "stabilization crisis" is inevitable if an economy built on inflationary growth is to be normalized. The growth rate of M_1 fell drastically between 1977 and 1980 (40.7,

24.9, 20.7, and 16.3 percent). But M_2, which includes savings deposits, fell more slowly than M_1 (39.7, 35.0, 24.6, 26.9 percent). Both wholesale and consumer prices, meanwhile, presumably due to the impact of the second oil crisis, rose at accelerated rates (CPI 10.2, 14.4, 18.1, and 28.6 percent). In other words, monetary policies cannot directly stabilize prices in an economy with built-in inflationary expectations. They may in fact incur the risk of inviting reduction in output. A negative growth of real GNP at −5.7 percent could not otherwise be accounted for.

Second, it is important to realize that the Korean economy, which is an investment-led type of economy, is marked by relatively mid-term, cyclical changes. The ratio, A_1 in Figure 2, of gross domestic fixed investment to GNP began to rise steadily from the mid 1960s, topping at 32.9 percent in 1979, well above the previous peak of 25.8 percent in 1969. There was another peak in 1975, which, however, was below the generalized trend of investment growth through the '60s and '70s as indicated by the straight dotted line, and thus may not represent an independent peak in any mid-term cycle of fixed investment. There is thus in effect a ten-year cycle between the last peak in 1969 and the latest in 1979, exactly in line with the Juglar Cycle of ten years' duration.

In a dynamic economy, fixed investment on the upswing grows faster than GNP, so that once the investment boom cools down, there is a countervailing adjustment period of three to four years during which the investment ratio tends to be pushed down.

A_1 or gross domestic fixed investment includes public investment as well as investment in the private sector, while A_2 represents private investment in plant and equipment. In the case of Korea and elsewhere, where the government plays a leading role, A_1 may be the better yardstick for explanation.

The share of capital goods in total imports, B in Figure 2, reveals an interesting pattern: a trough at 13 percent in 1965, a peak at 36.5 percent in 1968, another trough at 26.0 percent in 1974, and then up to 33.9 percent in 1978, which, except for 1965, traced a path just about a year ahead of the one exhibited by the fixed investment ratio shown as A_1. It should thus be possible to predict that the downward trend in the share of capital goods — 33.9 percent in 1978, 31.0 percent in 1979, and 23.0 percent in 1980 — will prove to be an advance indication of a largely reduced fixed investment
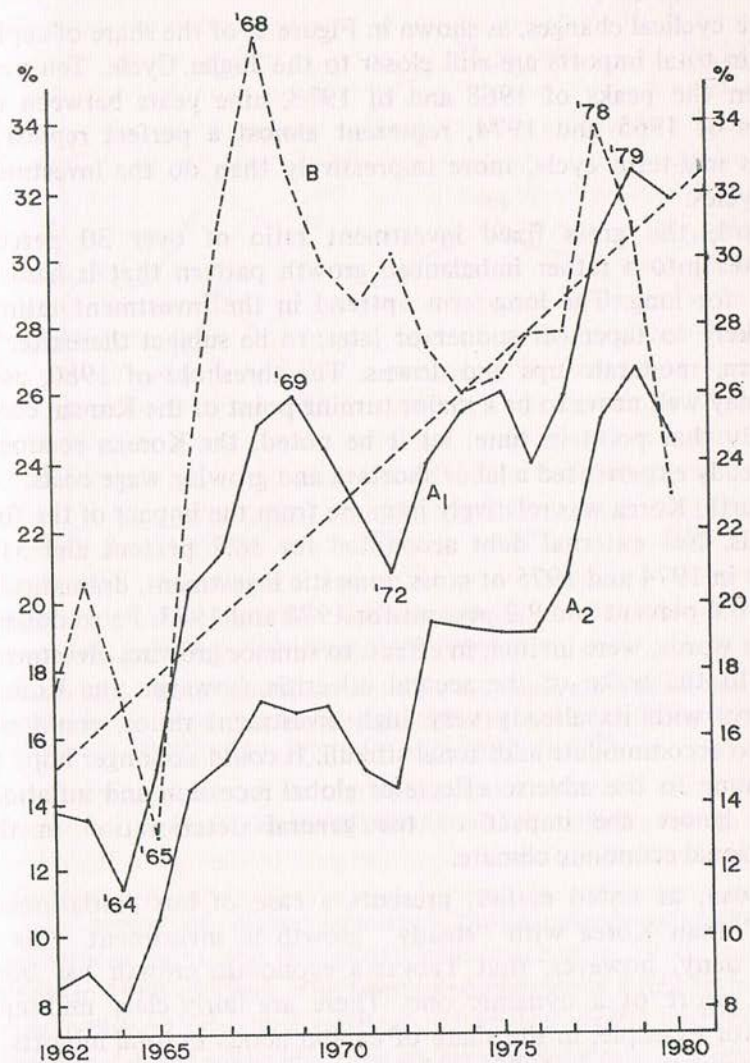
FIGURE 2
FIXED INVESTMENT CYCLE IN KOREA

ratio in 1981. In this sense, the recession beginning in 1980 has a downward adjustment of a mid-term cyclical nature in relation to fixed investment.

The cyclical changes, as shown in Figure 2, of the share of capital goods in total imports are still closer to the Juglar Cycle. Ten years between the peaks of 1968 and of 1978, nine years between the troughs of 1965 and 1974, represent almost a perfect replica of Juglar's mid-term cycle, more impressively than do the investment ratio cycles.

Third, the gross fixed investment ratio of over 30 percent translates into a rather imbalanced growth pattern that is hard to sustain for long. The long-term uptrend in the investment ratio is thus likely to taper off sooner or later, to be subject thereafter to mid-term, moderate ups and downs. The threshold of 1980, as it were, may well prove to be a major turning point of the Korean economy. By that point in time, let it be noted, the Korean economy had already experienced a labor shortage and growing wage costs.

Fourth, Korea was relatively immune from the impact of the first oil crisis. Net external debt accounted for 36.1 percent and 31.7 percent in 1974 and 1975 of gross domestic investment, dramatically above 16.6 percent and 9.2 percent for 1972 and 1973. Petro-dollars, in other words, were invited, in effect, to finance growing investment needs. In the wake of the second oil crisis, however, the Korean economy, with its already very high investment ratios, could not afford to accommodate additional stimuli. It could no longer hope to be immune to the adverse effects of global recession and inflation, nor to ignore the impact of the general deterioration in the international economic climate.

Taiwan, as noted earlier, presents a case of less "inflationary growth" than Korea with "steady" growth in investment. This is not to deny, however, that Taiwan's economic growth has been nothing short of a dynamic one. There are fairly clear mid-term cycles, for example, in the share of capital goods in total imports: a 13.1 percent trough in 1952, a 27.9 percent peak in 1960, a 21.4 percent trough in 1963, a 34.7 percent peak in 1969, and a 28.6 percent trough in 1973. Intervals of eleven years between the troughs of 1952 and 1963, of nine years between the peaks of 1960 and 1969, and ten years between the troughs of 1963 and 1973, all combine to demonstrate the ten-year Juglar cycle. Figure 3 has been drawn up to provide the Taiwanese counterpart to the Korean case in Figure 2.
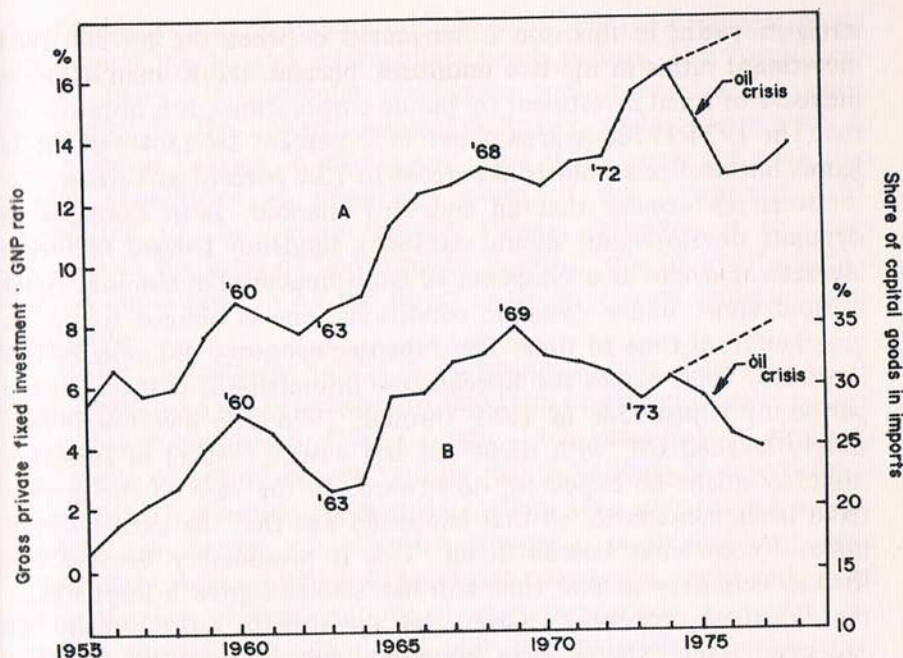
Notes: A = Gross private fixed investment GNP ratio.
       B = Share of capital goods in total imports.

Sources: A — Directorate-General of Budget, Accounting and Statistics, Executive Yuan, *National Income of the Republic of China*, 1979; B — Council for Economic Planning and Development Executive Yuan, *Taiwan Statistical Data Book*, 1979.

FIGURE 3
FIXED INVESTMENT CYCLE IN TAIWAN

In terms of either imported capital goods or private fixed investment ratio, the first peaks were reached in 1960, followed by those in 1968 or 1969. The third expected peaks failed to materialize due to the oil crisis and outflows of foreign capital, but up till then, there had been mid-term rises at regular intervals of eight to nine years, culminating in the peaks, as in the case of Korea, in 1968 and 1969. The Korean peaks of 1978 or 1979 did not repeat themselves in Taiwan, presumably because of the overwhelming pressures of the oil crisis.

Both the level of private fixed investment ratio and its rate of acceleration were higher in Korea than in Taiwan. Although no

straightforward comparison is warranted between the private fixed investment ratios in the two countries, because the Korean data are inclusive of fixed investment by public corporations, it is noteworthy that, in 1974-1978, it grew from 19.2 percent to 25.4 percent in Korea but declined from 16.3 percent to 13.8 percent in Taiwan.

It is no wonder that an economy marked, as in Korea, with dynamic development, should exhibit a tendency toward mid-term investment cycles as a symptom of entrepreneurial dynamism. After a rapid spurt under dynamic conditions, one is obliged to take a breather from time to time. The Japanese economy did more or less the same. What makes the Korean case interesting is that during the period of adjustment in 1969 through 1976, the investment rate simply levelled off, with slight ups and downs, instead of adjusting itself, as might be expected, downward. In the case of the private fixed investment ratio, all that happened was that the extent of the increase somewhat slowed down. This is presumably because the Korean economy at that time still had stronger growth inertia than the Japanese economy. Given its investment ratio already at excessive levels, the Korean economy will have to be adjusted downward in 1980s. The New Five-Year Economic Plan for 1982 through 1986 assumes an average fixed investment ratio of 30.8 percent, an all-time high that will be very hard to sustain. The share of capital goods in total imports, which anticipates the investment ratio, had already decreased from 31 percent in 1979 to 23 percent in 1980.

It is indeed very significant that the two dynamic economies among the Asian NICs are found to be marked typically by mid-term investment cycles, which have been known to occur so far in Japan and the United States. Economists should feel intrigued by the further parallelism in Korea and Taiwan.

4. Inter-Sectoral Imbalance and Socialist Economies

Among classical approaches to the business cycle, the aggregate gap between production capacity and effective demand has often been cited in accounting for changes in the business climate. The "underconsumption" theory of Hobson, Keynes, etc. and the so-called "capital stock adjustment principle" follow this approach. Another approach tries to analyze business cycles in terms of sectoral balance rather than of supply-demand gaps, Spiethoff and Hayek follow this strategy and try to find the essential trigger on downward

shift in business in "intersectoral imbalance" among consumer goods, investment goods, and intermediate goods sectors. The "overinvestment" theory in particular emphasizes such intersectoral balance. According to the underconsumption theory, underconsumption in the guise of "saving > investment" that occurs near the peak of a boom constitutes an important cause of the downward shift. According to the overinvestment theory, however, it is excess demand in the form of "investment > saving" due to credit creation that is considered to be the direct cause of sectoral imbalance and recession.

In his "Investment Cycles in European Socialist Economies," A. Bajt pointed to the occurrence of mid-term investment cycles in East European economies in 1951 through 1965. His points of emphasis lay, most significantly, on various manifestations of intersectoral imbalance in socialist economies, rather than on overall supply capacity in excess of effective demand, as might have been appropriate with reference to capitalist economies. Increasing social dissatisfaction at short supply of consumer goods, as well as the relative shortage of agricultural and raw materials production set back by heavy industrialization, etc. were the major concerns that Bajt concentrated on.

Indicators of fixed investment cycles in Hungary, Yugoslavia and China have been put together in Figure 4: net fixed capital formation (NFCF) over net material product (NMP) for Hungary, gross fixed capital formation (GFCF) over gross material product (GMP) for Yugoslavia, and the share of machinery and equipment in total imports for China. The dotted line for China shows the same for imports from Japan, apparently one year ahead of swings, both up and down, in total imports.

In the case of Hungary, an interval of just ten years between the peaks of 1953 and 1963, was followed by twelve years until the next peak was reached in 1975. Troughs in 1957, 1966, and 1977, occurred every nine to eleven years.

The cycles in Yugoslavia are somewhat shorter; eight years (1962-1970) between peaks, and another eight years between 1970 to 1978 or beyond. Troughs in 1957 and 1966 generally follow the Hungarian pattern. It is since the 1970s that the two economies have begun to behave differently, but the fact remains that cycles are not short-term but mid-term.

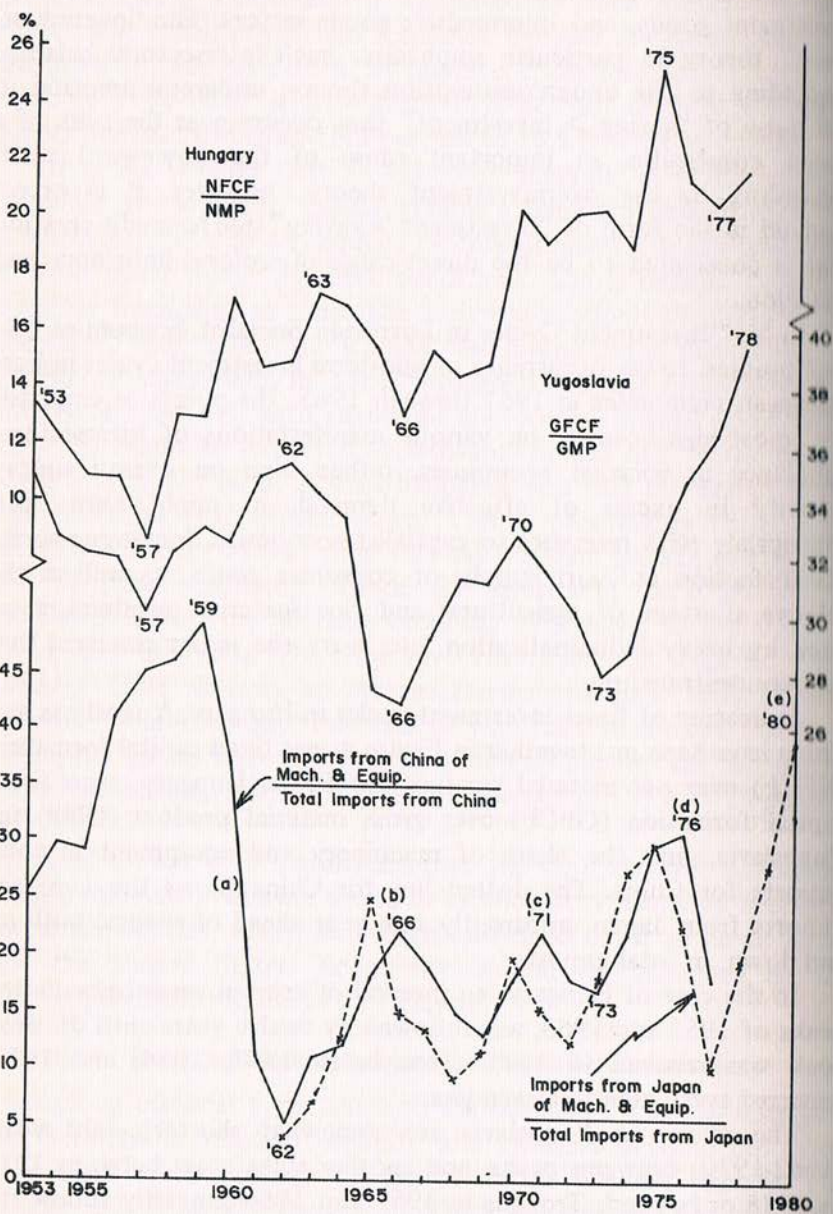In view of the parallel shifts in the investment ratio and share of

FIGURE 4
FIXED INVESTMENT CYCLE IN SOME SOCIALIST ECONOMIES

capital goods in total imports, as identified in the cases of Korea and Taiwan, the share of machinery and equipment in total imports has been chosen as the indicator for China. But the investment ratio, obtained from Kan Chao's and other estimates of capital formation in Mainland China, fails to reveal a corresponding pattern. Either income estimates are unreliable and trade statistics are to be preferred, or changes in trade statistics do not significantly affect a country's investment ratio — it is yet to be decided which interpretation is correct. It is assumed here for the sake of argument that the share of machinery and equipment presumably reflects changes in the domestic investment ratio. Should this assumption prove to be inappropriate, the following comments will have to be revised accordingly.

Tamio Shimakura at the Institute of Developing Economies in Tokyo used the share of machinery and equipment in China's imports from Japan, and discovered five year cycles, peaking in 1965, 1970, 1975, and 1980. He pointed out that every downward shift was associated with a major political incident. In contrast to "short-term political cycles" occurring in capitalist countries, the "Shimakura Cycle" indicates that Socialist China is characterized by relatively "mid-term political cycles." Let it also be noted that if the 1971 peak may be ignored as just a small rise in a short-term cycle, there is a good case for recognizing a ten year interval between the genuine peaks of 1966 and 1976.

Apart from such inferences, the Shimakura Cycle provides an important suggestion on the interactions between economic and political affairs in socialist societies.

Fixed investment enforced as planned and heavy industrialization carried too far tend to create an imbalance between agricultural and industrial sectors, and between light and heavy industries. Let these be known as "intersectoral" or interindustrial" imbalance. If this imbalance is allowed to reach excessive proportions, there are likely to be internal political disputes about the management of the economic crisis and the locus of responsibilities, which in turn may trigger a period of power struggles. Political instability adds to the seriousness of economic stagnation. Seen in this light, the process of economic contradictions due to excessive investment leading to political confrontation which in turn perpetuates economic stagnation can evolve as a matter of politico-economical dynamics in socialist societies.

China of course may not be the typical example, but it is still arguable that the Shimakura Cycle might not have occurred in the absence of the essential elements of such dynamics. It is important to remember that socialist planning strategies can alternate from heavy to light industrialization and vice versa. Excessive reaction to heavy industries tends to overemphasize light industries. Sewing machines and bicycles are produced in great numbers, causing iron and steel shortages. The Baoshan steel mill project, once postponed, thus enters its second phase of construction. Such a turn of events is an inevitable consequence of preoccupation with short-term phenomena that only makes for mid-term cycles in the investment ratio. In order for socialist planners to realize genuinely stable economic development, they should learn to rid themselves of short-term considerations and to work out, from mid and long-term perspectives, what constitutes a normal investment ratio and a balanced industrial structure suitable for stable growth.

In addition, there should emerge an established set of political rules of the game, if power struggles are to be avoided, and if mid-term economic cycles are not be politicized. Both political and economic conditions have to be set right before socialism can be a genuine success in Asia.

In her "Dialectics of Socialist Society: Polish Case," which has just been translated into Japanese, Jadwiga Staniszkis brilliantly described the changing process of movement and counter-movement in the economic, political, and social scenes in Poland. The overall background is provided by political-economic cycles that evolve as changing rates of investment anticipate alternating waves of totalitarianism and anti-totalitarianism. Investment actually exhibited negative growth in 1954-1957, 1969-1970, and 1976-1977.

A few comments may be in order here by way of conclusion:

(1) The theory of mid-term cycles has been denigrated in Japan as fatalism that fails to take sufficient account of policy impacts. But in Japan, the United States, Korea, Taiwan, and even in a few socialist countries, mid-term cycles could not be placed under control through policy measures. There is rather an undeniable tendency for policies and politics to be on the receiving end of the impact of dynamic investment cycles. It is high time, after one-third of a century of experience since the end of World War II, that a critical review of the possibility and efficacy of political control be initiated.

(2) It is rather ironical that the outmoded theory of the business cycle that attaches importance to inter-sectoral and inter-industrial imbalance as a result of excess demand — investment due to credit creation in excess of saving — should have been found to be applicable to mid-term cycles under socialist regimes. One of the problems that still remain to be solved is to define how this outdated theory needs to be revised under the current world economic conditions.

(3) While Keynesian thinking was prevalent, typologies of business cycles were deliberately shunned. Postwar textbooks on economic change frequently omitted reference to the waves of Kondratieff, Juglar, or Kuznets. It is very important at this point in time to reanalyze their waves from a new perspective free from the shackles of Keynesian ideology.

(4) Cycles are an attribute of dynamism, and growth is their shadow. The higher the dynamism of an economy is, the wider the amplitude of cycles in the investment ratio. The possibility, therefore, of controlling mid-term waves by aggregate demand management may diminish as dynamism increases.

(5) Finally, two types of growth were distinguished, inflationary and non-inflationary, in the rapid development of NICs. The view is that the latter is to be preferred as a sounder strategy.

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