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**Political Economy of Development**

**A Comparative Study of Regime Performance**

# Inclusive Development in Emerging and Frontier Asian Economies

## Political Economy Perspective

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# Contents

# Preface

It is a daunting task to come up with a unique idea of development. During the last seven decades after the Second World War, in particular, growth and development theories are propounded, debated, experimented and rejected. In the 1950s and ‘60s, foreign aid was granted as an engine of development. In the 1960s ‘Trade not Aid’ is identified as an engine of development. The neo-classical prescription of development theories based on industrialization as a panacea for all the economic ills occupied the center stage of debates in the 1960s through ‘70s. Harrod Domar’s Two Gap Model supported by external capital, ‘Trickle Down Theory’ and inequality as an incentive for saving, investment and growth, Balanced vs unbalanced growth in juxtaposition with the Theory of Big Push turned the tides of the debates on development. The urban-bias development expenditure is redirected towards decentralized public expenditures at the grass roots level and vicious circle of poverty turned to virtuous circle of poverty. This was to ensure basic needs based on participatory i.e. inclusive development.

In the 1970s and ‘80s, Mahbubul Haq’s Human Development Index (UNDP, HDR), Sen’s Capability Approach (Sen, 1982 and 1999) and Yunus’s Women Empowerment-all focused on human development from micro perspective as the foundation of enhancing human capability, wellbeing and development (Yunus, 2008). Despite immense contributions made by all these unique ideas there exist lot of both success and failed stories. Following the miraculous success of state-led open economy model based on appropriate institutions with distribution-oriented policies in the presence of state-led capitalism, a few South East Asian economies also started reaping the benefits of open economies under the garb of globalization. But vast majority of countries from the sub-shaharan Africa along with the Middle East and North Africa (MENA) are still struggling with extracted/exploited development strategies. Worsening inequality and unemployment coupled with the policies leading to multi-dimensional poverty and intensive deprivations were identified as the contributory factors to this failure.

The political instability and authoritarian regimes with decadent governance supported by the vested interests of the west continued with the distorted development institutions and ineffective class-biased policies. This worsenened both horizontal and vertical inequality in favor of extractive rather than inclusive development. The social injustices predominated over social justice. This calls for a new look at the pro-poor growth based on poverty and inequality reduction at the same time. This is to promote shared opportunities for all to establish social solidarity i.e. people economy as opposed to capital economy. Along with eight countries under the case study belonging to ASEAN (Association of South East Asian Nations), another three from South Asian Association of Regional Co-operation (SAARC) countries are studied.

Based on the development experiences it is argued that while the policies to promote micro, small and medium enterprises (MISMEs) were found to be instrumental in fostering pro-poor growth with social development in emerging and frontier East Asian economies. But pro-poor growth with priorities for social development also worked wonder to promote inclusive development in frontier south Asian economies, in general and Bangladesh, in particular. A number of studies initiated by the World Bank Group, The World Economic Forum, Asian Development Bank and Raihan in Parvez (2018) came up with a number of indicators for the pursuit of inclusive development via social development. This study uses a new methodology for materializing the desired goals of inclusive development based on social justice. While doing this, this study suggests that an inclusive growth strategy is required to take account of five types of inclusions.

The fundamental issue here is to address the problems relating to the drivers of inequality as the World Bank group calls it. However, it is pertinent to remember that inequality is multi-faceted in nature. It can be either Vertical Inequality (VI) measured by size distribution of income or horizontal inequality (HI) measured by social stratifications as manifest through the cover Page. While the former (VI) focuses on the general distribution of income by size across the income ladders regardless of any grouping, the latter (HI) is concerned with how the different groups in the social hierarchies (cover page) benefit from growth caused by the distribution of productive assets.

Hence, to overcome the problems emanating both from VI and HI redistribution of all sorts of productive assets needs be addressed. It is argued that without effective implementations of appropriate macro-level policies the pursuit of pro-poor social development cannot be sustained. Here comes the relevance of political economy perspective to examine the nexus between politics and institutions, on the one hand and macro-economic policies and outcomes, on the other. Therefore, the analysis of this study focuses on creating opportunities for all regardless of any artificial or man-made barriers. It is quite obvious that the perpetuation of inequalities limits the opportunities. This, in turn, contributes to unequal development manifest through non-inclusive, non-participatory or exploitative development. The end result is the most deprived are by-passed thereby constraining the expansion of growth concomitant with opportunities as well.

The success of inclusive growth strategy depends on the five types of inclusions such as, economic inclusion (EInc), social and cultural inclusion (SCInc), political inclusion (PInc), ethical and moral inclusion (EMInc) and global inclusion (GLInc). To incorporate all these inclusions almost 110 cluster indicators are used. These indicators capture all the indicators used by the World Bank Group, World Economic Forum together with many other research works sponsored by Asian Development Bank and IMF focusing on pro-poor growth with reduced inequality. It is argued that the pursuit of social development canbe sustainable with no gender bias and human capability, in particular. All these are found to be instrumental in alleviating human poverty, in general along with intensity of multiple deprivations thereby reducing inequalities for unleashing the further growth potentials from micro and macro perspective.

This study selected four emerging and seven frontier economies from Asia to test our model of inclusive growth strategy. It is expected that the countries mostly from sub-shaharan Africa and MENA can draw useful lessons from the diverse experiences of these Asian economies for pursuing inclusive development strategy.

# Introduction

The debate of the 1950s through 1970s concerning the 'Trickle Down Theory of Development' took a new twist in the 1990s. The disastrous effect of this theory primarily developed on the historical experience of early industrialized countries was manifest through worsening inequality. This, in turn, sowed the seeds of economic, social and political instability regardless of any geographical divides. The proponents of the 'Growth alone Syndrome' advocated that irrespective of the initial distribution of productive resources, the spill-over effects of continuous growth will create the opportunities for those who failed to participate and benefit from the market. In other words, economic growth will absorb all those in the labor force without having any access to productive assets or resources. Obviously, these resources include natural capital i.e. Land, water and forest, financial capital and human capital. But the unequal ownership of productive assets to begin with contributed to unequal growth not in favor of inclusive development (ID). Those having access to the productive assets experience higher increase in their incomes compared to those with little or no assets. This, simply put, implies the higher the growth the higher will be the rate of widening the income gap between the asset-less and asset-owning class. This is because the return to the factors of production other than labor and most particularly capital increases as a faster rate than that from labor as strongly argued by Piketty (2014). Hence, in the absence of policy intervention for market correction it takes a long period before the asset-less labor class starts benefiting from the spill-over effects of growth in terms of higher real wages.

It is pertinent to revisit the forces that drive inequalities that worsen rather than promote inclusive development. It is argued that four primary forces of inequality include: (i) Circumstances based on gender and task; (ii) Opportunity based on education and health; (iii) Mobility based on jobs and cities and (iv) Supports based on social protection, taxes and transfers. All these combined together can act as a proxy for social transformation or what can be called social development (World Economic Forum, 2017).

To counter the worsening effect of growing inequality the debates on growth with redistribution began since the mid-1970s. The success stories of East Asian state-led miracle economies (World Bank, 1993: Lingle, 1996) set a new direction of development strategy based on growth with redistribution. A number of studies sponsored by the World Bank came up with the finding that the appropriate policy intervention initiated by equally efficient and developmentally committed governments can foster rapid economic growth with better distribution of income. The success of the authoritarian-led developmentalist government of South Korea, Singapore and Taiwan proved that development without equal participation of all the economic agents of change cannot be sustained.

The unequal development aimed to benefit the privileged as opposed to the vast majority laid the foundation for less development based on participation. The aid financed dependent development via industrialization using comparative advantage defying rather than following strategy failed to create equal opportunities for all. The economic, socio-cultural and political instability resulting from such distorted development as pursued particularly by oil-rich countries (MENA) prepared the ground for exploitative development. The debate on ID has implications for another slogan of the World Bank on 'growth with jobs' as opposed to 'jobless growth'. So, ID that can be made possible through creating shared opportunities for all needs be based on inclusive growth strategy (IGS). The success of IGS primarily depends on power-sharing in pragmatic sense. The power-sharing, is highly linked to economic, socio-cultural and political dimensions. Since all the economic agents of change including business firms, individuals are motivated by their worldly material interest, there is a need for a moral filter as well. This brings the issue of ethical and moral values to guide all the stake-holders to promote ID for the benefit of social solidarity and peaceful coexistence.

The, ID based on IGS has also implications for social solidarity and community-building, so essential for fostering social capital through social networks. Therefore, people economy built on social networks and empowerment is likely to strengthen integration at the community, regional and national level. In this context the unprecedented growth in information and communication technology (ICT) has further widened the scope for global integration. This is quite evident by now that the benefits from global integration are instrumental in materializing the goal of inclusive development. Thus, economic inclusion fostered by Global Inclusion (GLInc) emerges as the most effective one out of the five elements of inclusion.

After the years of intensive deliberations to counter vicious circle of poverty with its associated risk of instability and vulnerability to recessions, World Economic Forum came up with the virtuous circle of inclusive growth and development (World Economic Forum, 2017, part 1). According to WEF there can be seven pillars that can interact with five other sub-pillars or policy indicators such as: (i) Equitable taxation and social protection; (ii) Building blocks of human potential and opportunity; (iii) Sound Institutions, business on political ethics; (iv) Productive allocation of financial resources and (v) Good jobs, wages and livelihoods. All these five policy areas are linked to proposed seven pillars. Pillar-1 puts thrust on education and skill-development and pillar-2 on basic services and digital information. Infrastructures are treated under building blocks, corruptions and rents under social institutions, financial intermediation under productive allocation, employment and asset building under good jobs and fiscal transfers under equitable perception and social protection.

The World Bank and Bangladesh center for Advanced Studies Examine the virtuous circle of human development and growth from the perspective of productivity, Human Capital and social protection. In doing that the world bank considers six sub-sectors such as, education, health, nutrition, population, training and employment. These sub-sectors are capable of accomplishing the goals of poverty reduction, enhancing quality of life and national income.

The inclusive development index (IDI) based on the overall scores and ranks using all the seven pillars with five sub-pillars can be used for understanding the comparative development performance of our four emerging and seven frontier economies (vide app. Tables 1 & 2). Like all other comprehensive indexes used here as cluster indicators, social progress index (SPI) primarily focuses on three dimensions namely, basic human needs (BHN), Foundation of wellbeing (FW) and opportunity (Opp). All of these three indices are linked to four very associated components. The overall performance in SPI with particular emphasis on opportunity helps us to evaluate the progress in inclusive development Index (IDI). Our cluster indicators used for Social and Cultural Inclusion (SCInc) and Political Inclusion (PInc) take account of the elements of opportunities as used to measure SPI. Our findings based on the indicators like IDI, SPI, LPI, World Happiness Index Ranking (WHIR) and Average Score on World Governance Indicator (ASWGI) suggest that the poverty targeted policy-concomitant with appropriate institutional and infrastructural foundation can significantly explain the overall performance in inclusive development. As such, the level of development proxied by income per capita alone may not fully reflect the degree of achievements in IDI based on IGS as elaborated under methodology in chapter one below.

In this regard, the historical legacy mixed with culture (Serageldin and Taboroff, 1994: Schech and Haggif, 2000 & Inglehart, 2003) and ideological background of the leadership (Raj, 1987) is also found to be instrumental in achieving inclusive development. This is evident from countries with lower ranking in GDP per capita but with much better ranking in IDI. The findings (WEF, 17) suggest 18 out 82 developing countries show an IDI score that is 9 places or more above their GDP per capita ranking. Six of these better-performing countries include Azerbaijan, Nicaragua, Vietnam, Cambodia, Bangladesh and Nepal.

The records on IDI scores of these countries lie 20 or more places above GDPPC ranking. This suggests their developing strategies are based on balance / inclusive growth. By the same standard, the performance of even the US-the super power shows declining in terms of IDI. USA having ninth ranking in GDPPC, ranks 23$^{rd}$ on IDI thereby depicting more concentration of wealth in the recent past (Piketty, 2014). Surprisingly, India that claims to be the biggest democracy on earth appears to be one of the worst performers in IDI ranking (60) with comparatively better ranking in GDPPC (52). South Africa being ranked 19 on GDPPC records a rank of 70 in IDI followed by Namibia having GDP ranking of 25 with 63 on IDI, Colombia with GDPPC ranking of 21 but IDI rank of 33, Mexico with 17 in GDPPC ranking has only 29$^{th}$ in IDI. While Brazil with a high GDPPC ranking of 10 records only 30 in IDI followed by Venezuela with GDPPC ranking of 8 but IDI rank of 26 and Turkey with a GDPPC rank of 9 scores a rank of 20 in IDI (WEF, 2017).

## Why Emerging and Frontier Economies?

It has been well-recognized that a number of countries from south Asia and South East Asia have been doing very well during the last three decades. The very high sustainable growth spurred by four East Asian miracle economies since the 1970s can claim to have laid the foundation for this. The most oft-quoted miracle economies include South Korea, Taiwan, Singapore and Hong Kong. In this regard, the role of a single most industrialized country in Asia-Japan as a pace setter cannot be ignored, either. However, another two most populous and Giant Asian members-China and lately India joined the rank of best-performing emerging economies in the world. The success story of these two economies is triggered by the massive economic reforms in China since the end of the 1970s. On the other hand, despite mountainous lobby against economic liberalization, the Indian leaderships had to succumb to the pressure of economic reformists almost a decade after China, a closest rival of India (Rajadhyaksha, 2007). The infant industry argument juxtaposed by import substitution industrialization aimed at attaining self-reliant growth was given the top most priority in India’s state-led industrialization since independence. In fact, the ideological basis of founding father-Gandhi and Nehru laid the foundation of this development strategy supported by more of political freedom and less of economic freedom.

The significant rise in inter-regional flow of goods and services, in general and the massive migration of both skilled and semi-skilled professionals and workers, in particular, are found to be quite instrumental for the remarkable performance of some selected countries in Asia under this study. The prevalence of relatively peace period after the political turmoil and devastation for nearly two and a half decades after the Korean War of 1951 followed by cold war (1951-'76) did create an enabling environment for the economic agents to unleash their potentials. Of course, the massive inflow of FDI both inter-regional and extra-regional acted as a catalyst for achieving remarkable growth in emerging economies, first, followed by some other frontier economies in Asia.

Based on high sustainable real GDP growth for nearly quarter of a century (1990-'14), IMF (Shipke, 2015) identified four out of all the remaining revolutionary economies namely, Malaysia, Thailand, Indonesia and Philippines under emerging market economies. Judged by the same criteria, IMF classifies another 12 countries under Frontier and Developing Asia (FDA). These FDA includes Bangladesh, Bhutan, Cambodia, Lao PDR, Maldives, Mongolia, Myanmar, Nepal, Papua New Guinea, Timor-Leste, Sri Lanka and Vietnam. Having recognized their remarkable success in terms of growth with better distribution of the four emerging economies (EEs) and four Frontier Economies (FEs) including Vietnam, Laos, Cambodia and Myanmar this study initially focused on ASEAN countries (ASEAN 8) excluding two outliers-Singapore and Brunei. It seems their exists one fundamental commonality in all these eight countries (ASEAN 8). This is based on one Vision (V), one Identity (I) and one Community (C) or what is called VIC. This is within the fold of ASEAN Economic Community (AEC) initiated in the late '90s.

The main contributory factor to the pro-poor inclusive growth of AEC appears to be the overwhelming priority for Small and Medium Enterprises (SMEs). Later on, SMEs move one step further to include the predominance of informal sectors under Micro Enterprises (MIEs). Our findings indicate that the contribution of the lower and lower middle income households engaged particularly in MIEs and SEs in materializing the desired objectives of inclusive growth strategy (IGS) is simply remarkable. The reasonably good performance in inclusive development index (IDI, vide app table 2, col. 61) of all the ASEAN 8 in this study, thus, testifies that in the absence of policy priorities for pro-poor growth many countries fail to achieve inclusive development. This is evident from countries of other regions particularly from Middle East and North Africa (MENA) for not being able to achieve similar level of IDI (WEF, 17) even with much higher GDP per capita. As hinted above only around one-fifth of developing countries (18 out of 82) covered by WEF, 17, performed better in IDI at the similar level of development.

This study also includes 3 out of 78 developing countries having very high incidence of poverty. The IMF study (Shipke, 2015) puts these countries under Poverty Reduction Growth Trust (PRGT) list of 2008. These three countries, India, Bangladesh and Pakistan belonging to another rather dysfunctional regional block i.e. SAARC (South Asian Association of Regional Cooperation). Despite being geographically quite contagious even in more than three decades SAARC did not have chance to blossom. According to Yunus-The Nobel Laureate for Peace SAARC became more a forum for political upmanship. Hence, unlike ASEAN, it fails to build trust and co-operation among the member countries. The pursuit of development strategy in ASEAN and SAARC differs substantially. While the former pursued the Khaldunian theory of 'feeling of togetherness as a community' (Asabiyyah, in Arabic), the latter utterly failed to adopt to this philosophical foundation even in the last more than three decades.

In terms of overall performance these three quite dominant members in SAARC have not been performing as fairly as other four late-comers to ASEAN namely, Vietnam, Laos, Cambodia and Myanmar. This is primarily because of continuous political conflicts of interest among them since independence from Britain on 14$^{th}$ August, 1947. Interestingly, four late-comers to ASEAN are also among 20 frontier economies excluding India and Pakistan (Shipke, 2015). According to another classification by Morgan Stanley Capital International (MSCI in Shipke, 2015) 5 out of 21 emerging market economies such as India, Indonesia, Malaysia, Philippines and Thailand are included in this study. Another 2 out of 26 frontier economies (MSCI, Shipke 2015) include Bangladesh and Pakistan.

It is quite evident from this study that there exists a trade-off between unequal development based on unequal growth and inclusive development based on shared opportunities. As argued, these opportunities, however, need to be understood from economic, socio-cultural, political, ethical and moral and global perspectives. As such, the two most fundamental macroeconomic destabilizing factors like unemployment and inflation cannot coexist with inclusive development. Hence, the pursuit of pro-poor growth aimed at achieving inclusive development must focus on social development for the less privileged. Only by doing this, poverty and inequality-reducing effects of pro-poor growth with priorities for domestic demand contrary to external demand-led growth can ensure the sustainability of inclusive growth strategy (IGS). This has been empirically substantiated by more than 110 indicators and co-indicators used in this study. Based on the intermingling nature these indicators are also being treated as cluster indicators as will be apparent from the discussion on methodology that follows.