The Developing Economies, XXIX-3 (September 1991)

BOOK REVIEWS

Economic Development and International Trade: The Japanese Model by Ippei Yamazawa, translated and revised by Ippei Yamazawa, Honolulu, Resource Systems Institute, East-West Center, 1990, xvi+270 pp.

The economics profession should be extremely happy that the English version of Professor Yamazawa's analysis of the past interaction between production and trade in the Japanese development process has now been published. It essentially relates to the core of the Japanese industrial development, the process of the so-called catching-up product cycle (CPC) development, and to the role of the government industrial policy accelerating and facilitating interaction between the trade structure and the composition of industrial production. The book ends with a discussion on the extent to which the experience of Japan as a late-developing country is relevant and instructive to the problems facing the present-day developing countries.

An important side-condition was the successful completion of Toyo Keizai Shinposha's Chōki Keizai Tōkei [Estimates of long-term economic statistics of Japan since 1868] Series on which the author's analysis of the development mechanism in a long-term historical perspective is based. In the nature of the subject, this is a standard work which could serve as a textbook in a class room on the most remarkable and successful development of the recent past, the Japanese development model. In that sense, the fact that *Nihon no keizai hatten to kokusai bungyō* [Japan's economic development and international division of labor] (1984) has now become available in English is of far-reaching implications for a better understanding of the Japanese contribution to economics and economic policy.

A few words must be said about what is implied by the adoption of the CPC development model, or of the product cycle (PC) development model in general, for the general direction of contemporary economics. When Raymond Vernon suggested the concept of the product cycle in 1966, he was on a "search for better tools" into "one promising line of generalization and synthesis which seems to have been somewhat neglected by the mainstream of trade theory"[1] and the equilibrating international mechanism. The concept reflected "attempts to relax some of the constraints imposed by purer and simpler models."[2] The same applies to Professor Yamazawa's concept of CPC development. In line with the currently established usage of the word, this may be called a method of finding empirical regularities, or "stylized facts." The essence of the method consists of subordinating deduction to induction, far removed from the application of high-sounding principles of the great systematizers, like the principle of comparative advantage based on equilibrium analysis of factor proportions. Recognizing this difference, the author says "The CPC development process differs from this orthodox view by stressing the continuity of import substitution while pursuing export expansion" (Preface, p. xi).

1 Raymond Vernon, "International Investment and International Trade in the Product Cycle," *Quarterly Journal of Economics*, Vol. 80, No. 2 (May 1966).

2 Ibid.

I suspect that the question of whether import substitution is continuously required in the process of export expansion, or for that matter whether import substitution is a necessary link in the first stage of industrialization and demand expansion cannot find an adequate answer in terms of an abstract economic theory based on general equilibrium analysis of supply and demand. In practice, import substitution was invariably the initial strategy, implying that domestic demand had been nurtured by imports from abroad. This issue is not only of historical interest, but is also of practical significance to those developing countries which may not yet have completed the first and easy phase of import substitution. This is an additional source of relevance of Professor Yamazawa's analysis for Third World countries. The case for the CPC development model is thus built on real world experience rather than on pure and abstract theoretical reasonings. This is why the case is so powerful and appealing to practical policymakers.[3]

The method of finding empirical regularities on the basis of inductive logic has thus become a hallmark of those economists who attempt to keep theoretical work in close contact with reality, in contrast with the general equilibrium theory which tended to stress the strict logical consistency of a priori reasonings; on that basis they have developed a method of establishing hypotheses which can be refuted by stylized facts. These facts are not invariably true in every conceivable instance; the CPC development, for instance, would not have been successful if not buttressed by increasing domestic demand or by improvements in efficiency. But, they are true in the broad majority of observed cases. Hypotheses which relate to particular aspects of the economy may be discarded if they prove inconsistent with other observed features and then be replaced by something else, whereas the general equilibrium theory includes also axioms that are demonstrably untrue or that are incapable of being verified or refuted, such as that of optimizing behavior.

In Professor Yamazawa's analysis, the long-run Japanese data on production and trade were pursued in the context of a long swing of twenty years' duration (p. 41), which is suggestive of the existence of Kuznets's or construction cycles. The author has, however, refrained from delving further into the problem complex relating to cycles and growth, a problem leading to uneven development characteristics of the modern world economy. The basic CPC development model has been linked with other industries by forward and backward linkage effects, with the resulting diversification mechanism of production structure in the process of industrialization. The increased availability of capital and entrepreneurship gives rise to a multifactor, multi-commodity model, and the learning-by-doing effect helps the transfer of one industry's CPC to the other, comprising various stages of light and heavy industrialization. True to Kaname Akamatsu's original extension of "flying wild geese pattern" to a multi-country model, the CPC development will be transferred from one country to another, with managerial resources being shifted from an early to a late-starting country through licensing agreements or direct foreign investment. "A peculiar characteristic of structural changes in Japan's production and trade" would thus consist of "the same change, beginning with light industrialization and moving to heavy industrialization," which "first occurred with imports, then with production, and ended with exports" (p. 43).

Part III of the book entitled "The Role of Government in Industrial Growth"

[3] See James Riedel, "Strategic Wars: the State of Debate on Trade and Industrialization in Developing Countries," in *International Trade and Global Development,* ed. Ad. Koekkoek and L. B. M. Mennes (London & New York: Routledge, 1991), in a somewhat different context.

deals with the controversial question of industrial policy, but it is not an easy matter to identify the author's position on disputed points. With regard to the CPC development mechanism, Professor Yamazawa recognizes that "the government's protective and industrial nurturing policy certainly contributed to the promotion of the CPC development," but immediately adds that "except in the case of strategic industries such as iron and steel and automobiles, a high-handed nurturing policy was rare. Rather, the Japanese government offered indirect support, including the development of necessary infrastructure" (p. 108). That means that the government policy basically differed from industry to industry. The policy differed also from time to time and proved highly flexible and adaptable. "Japan's trade policy should not be viewed as a consistent policy that was adopted methodically over the high-growth years, but rather as one that gradually evolved from an initially protective policy to one of trade and capital liberalization" (p. 165).

In spite of the differences in time and industries, the Japanese government has generally had a protective attitude toward private firms which have basically achieved a consensus with the government on the need for economic development. The uniqueness of the Japanese relationship between government and business is generally accepted. In the rapid growth period, the government adopted an active promotion policy for a number of industries targeted for special nurturing, and "the success of this industrial policy, which the OECD labeled a 'picking-the-winners' policy, has attracted attention both in Japan and abroad" (p. 171). Opinions diverge, however, as to the degree of government leadership and its effectiveness, because a number of other factors, such as expanding and competitive market, supply of foreign technology, and adaptability of Japanese firms, were also responsible for the rapid economic growth.[4] The point the author is especially inclined to stress is that with the lapse of time the special incentives of these promotion policies "had little quantitative importance" (p. 171), which means that the Japanese government delayed liberalization too long until the degree of international competitiveness had been achieved. "The success of this strategy is evident, because upon liberalization, Japanese firms were already competitive. However, it is partly a result of this success that Japan and its trading partners are now experiencing trade friction" (p. 180).

It is a moot question whether the recent trade frictions between Japan and its trading partners are results of the delay in liberalization or of the success of the past promotion policy. In any case, we must differentiate between the macroeconomic policy relationship which is responsible for trade or current account imbalances and the microeconomic problems of international competitiveness which may directly cause conflicts between national firms. But the fact of modern world economy is that one center grows at a faster rate while other centers' growth is diminished. In contrast to the classical theory of international trade according to which trade is bound to benefit all participants equally, the world economy characterized by dynamic increasing returns, imperfect competition, and endogenous changes has a tendency to polarize manufacturing activities, with Japan at the pole of enhanced growth. In this interpretation, trade frictions are intimately linked with the disequilibrating world economy, far from

[4] The majority of the neoclassical economists of Japan is inclined to minimize this effectiveness. Representative of this view is Ryutaro Komiya, Masahiro Okuno, and Kotaro Suzumura, eds., *Industrial Policy of Japan* (San Diego: Academic Press, 1987). The readers should also consult Miyohei Shinohara, *Industrial Growth, Trade, and Dynamic Patterns in the Japanese Economy* (Tokyo: University of Tokyo Press, 1982), for a differently focused view.

being results of delayed liberalization or the somewhat closed nature of the market of a late-developing country. Regardless of the justification for any foreign demands for further liberalization of the Japanese market, the question of international competitiveness of manufacturing industries should be addressed from quite a different angle.

Finally, the Japanese experience of the CPC development is consciously related to the problems facing the present-day developing countries. A lively debate was going on both in Japan and in the developing countries as to the extent to which the country's successful experience of development is relevant and instructive to the Third World countries which may wish to follow in the footsteps of a late-developing country. The author's well-considered conclusion seems to be that to the extent that the conditions for successful CPC development are given, the Japanese experience is fully applicable to other developing countries. But the historical uniqueness of the international and domestic conditions Japan faced should be taken into full consideration. After all, a blind copying of Japan's procedures cannot provide any effective solution to the existing problems. An effective policy must be based on the objective analysis of the given conditions. (Hiroshi Kitamura)

China: Macroeconomic Stability and Industrial Growth under Decentralized Socialism by World Bank, A World Bank Country Study, Washington, D.C., 1990, xxi+299 pp.

Since China's participation in the World Bank in 1980, the Bank's commitment to the development process of the country has been expanding rapidly. It has extended beyond financial or technological assistance to consultation to China's leaders and technocrats on the market-oriented economic reform.

The Bank surveys China's economy occasionally, and the findings are summarized as country economic reports. Among those issued in the 1980s, two comprehensive reports based on the surveys conducted in 1980, immediately after China joined the Bank, and in 1984 were most influential.[1] Some of the policy proposals affected the decisions of the China's leadership as revealed in a recent study.[2] The report I review below, though neither as voluminous nor as comprehensive as the preceding two,[3] presents a more clear-cut image of China's future development strategy.

The report consists of two parts. Part One deals mainly with issues related to macroeconomic stabilization. Part Two takes up problems in the supply side. I will focus on the policy proposals set forth in these two parts.

[1] World Bank, *China: Socialist Economic Development,* 3 vols. (Washington, D.C., 1983); idem, *China: Long-Term Development Issues and Options* (Baltimore, Md.: Johns Hopkins University Press, 1985).

[2] H. K. Jacobson and M. Oksenberg, *China's Participation in the IMF, the World Bank, and GATT: Toward a Global Economic Order* (Ann Arbor: University of Michigan Press, 1990). See also Vanessa Lide, "The World Bank in China: Getting Back on Track Is Slow Going," *China Business Review,* Vol. 18, No. 1 (January–February 1991).

[3] In particular, external trade is not detailed in the report.