

Development finance for structural
transformation and inclusive growth:
Asian experiences

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1. Role of development banks in East Asia: An overview

- According to WB, *East Asian Miracle*
- Development Banks: East Asian governments created a wide range of financial institutions to fill perceived gaps in the types of credit provided by private entities.
- They **addressed the need for long-term credit for industry** by creating development banks.
- Most have also created specialized institutions that provide **credit to agriculture and small firms.**

- Industrial development banks have been substantial long-term lenders in Indonesia, Japan, Korea, and Taiwan, China, but not in the other High Performing Asian Economies (HPAEs).
- In Japan, the development banks, the public Japan Development Bank (JDB) and the private Industrial Bank of Japan (IBJ) accounted for about two-thirds of loans outstanding for equipment investment in the 1950s and about half in the early 1960s.
- Their share in total lending to industry was small, however, and has declined.

- At its peak in 1953, the JDB accounted for 18 percent of new funds lent. Starting in the mid-1950s, JDB lending fell to 1-6 percent of new lending; the rest was accounted for by private banks.
- The Korean Development Bank made an average of a third of all loans and guarantees in the 1970s, and the development bank of Taiwan, China, the Bank of Communications, holds about half of the assets of the banking-system.

- **Development banks have performed much better in the HPAEs** (than other developing countries), especially those banks in the northern tier economies concentrating on industrial finance.
- **Financial performance has been adequate** to good, and the capacity to evaluate and monitor projects has at least in Japan created spillovers for the rest of the formal financial system.
- Successful development banks in East Asia have applied **commercial criteria in selecting and monitoring projects and firms**, even within constraints set by government priority activities.
- Development banks in Japan and Singapore, for example, must select projects that will repay, since the banks are expected to repay with interest the funds they obtain from the government.

- Most East Asian governments have devised means to **contain willful political interference** in development banks.
- Japan, Korea, and Taiwan, China, have appointed senior officials from ministries of finance as chairmen, so they may withstand pressure from other parts of government. Others have controlled the types of lending. Thailand simply disallowed its development bank from lending to state enterprises.
- The **high professionalism** and institutional identification of staff which is characteristic of successful development banks, is a positive factor as well.

2. Industrialization in Asia: Development banks and foreign direct investment (FDI)

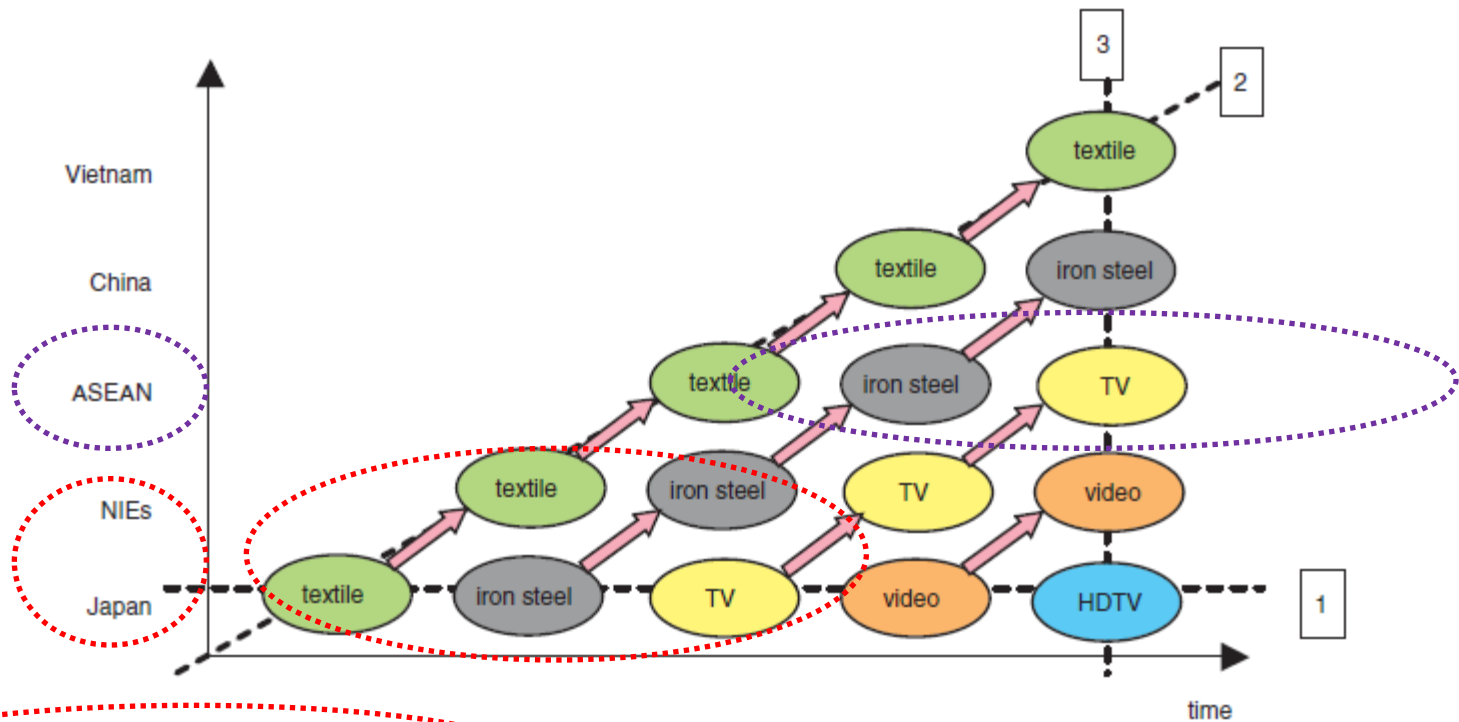
Far East Asia (Japan, Korea and Taiwan)

- Industrialization started when global investment and financial flow was limited
- Public financial institutions (such as **development banks**) played the major role in industrialization
- **Public financial institutions (and commercial banks) supported small and medium industries.**

South East Asia (mainly ASEAN)

- Industrialization coincided with the globalization process of investment and financial flows
- **FDI** played the major role in industrialization
- **Public financial institutions (and commercial banks) supported small and medium industries.**

● 1-6 Pattern of Industrial Structural Change in Asia

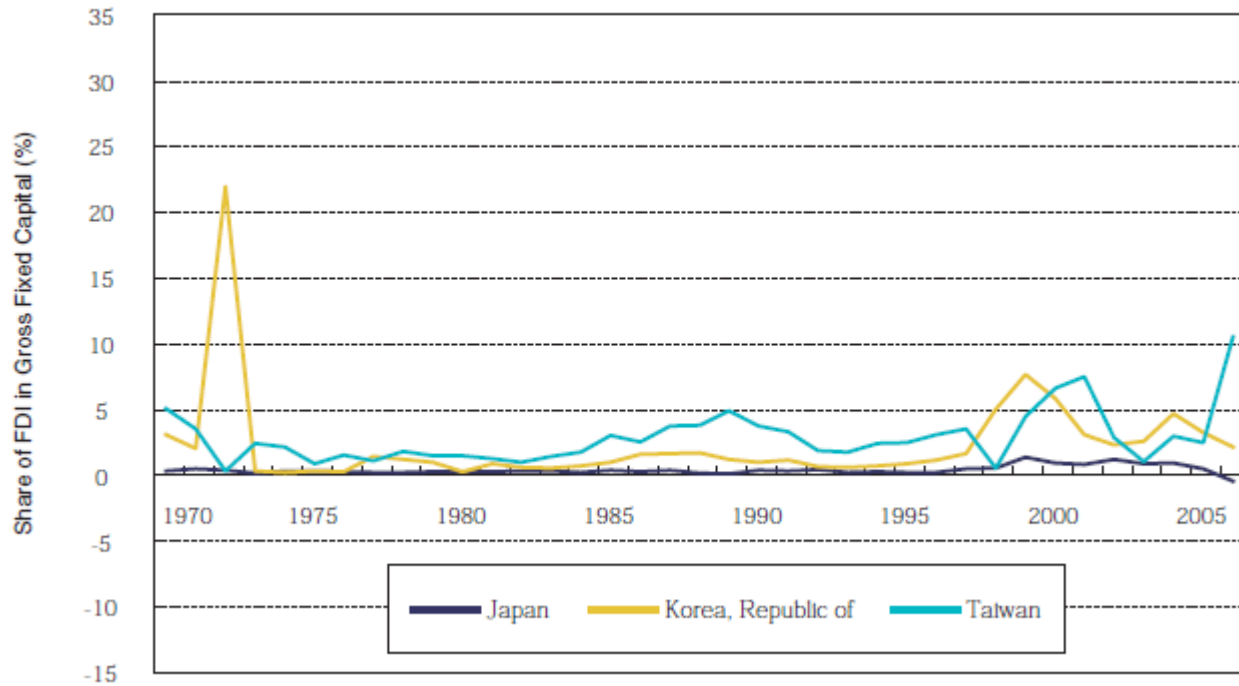


Before the globalization of trade and investment

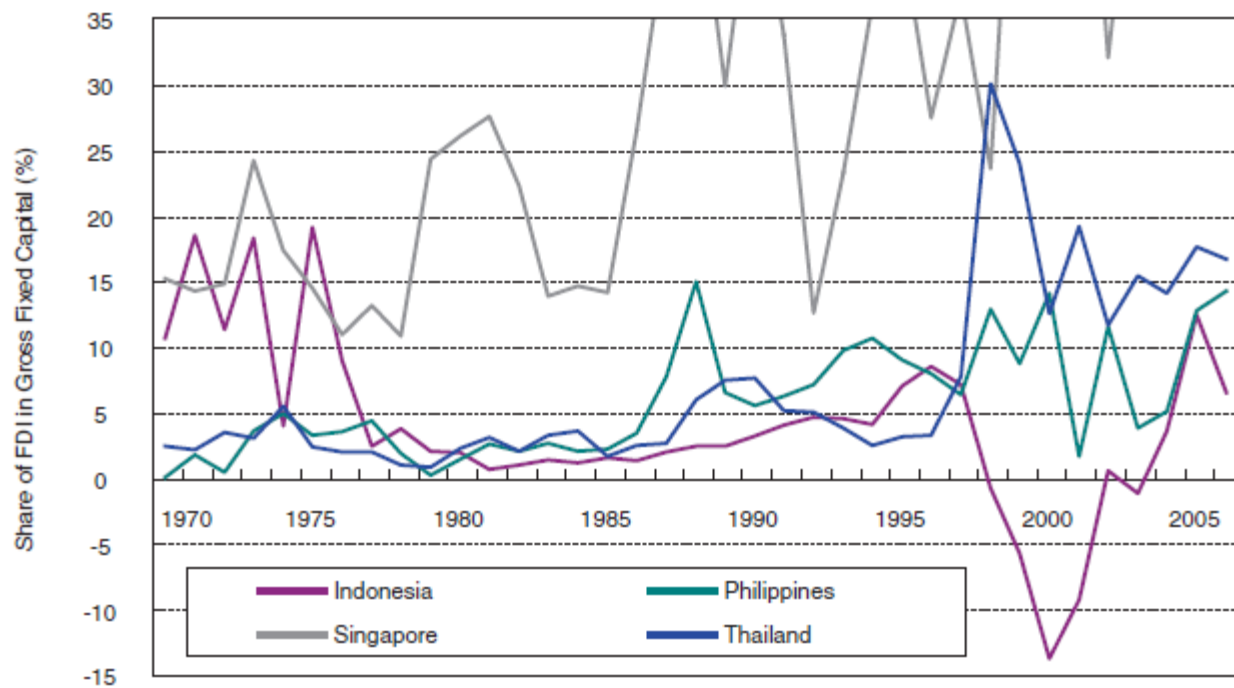
Globalization of trade and investment

- Dependency on foreign capital is generally low for **Japan, South Korea and Taiwan** as the share of FDI against gross capital formation in these countries amounts to **not more than 5%** for most of the period.
- While **in ASEAN countries**, the FDI dependency is extremely high, as the ratio hovers around **10-15%** for Indonesia, the Philippines and Thailand after the 1980s (except for the Asian currency crisis period), not to mention the case of Singapore which is highly dependent on foreign capital.

'Domestic-Capital-Dependent' Approach



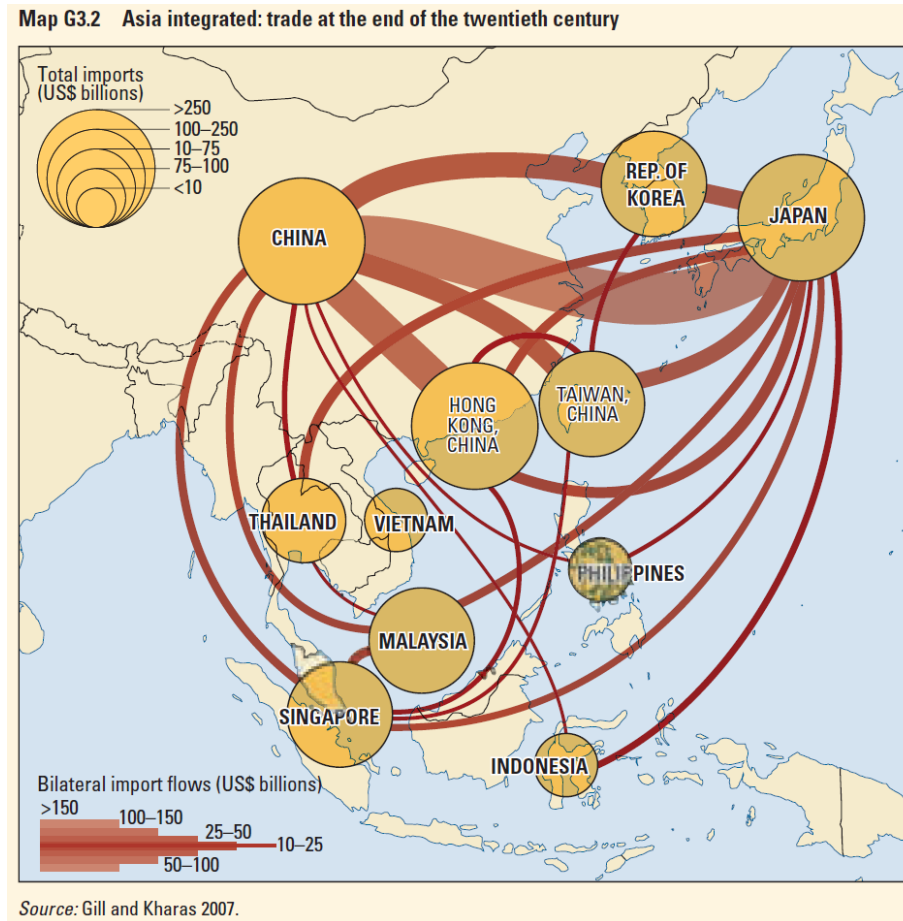
'Foreign-Capital Dependent' Approach



Source: UNCTAD, FDI database

Production network in Asia is much more complex, today

WDR 2009



3. Comparison between Far East Asia Model and ASEAN Model: (1) Development strategy

Far East Asia

- Industrialization with preferential interest rate, in which **government accomplished the role of coordinator** between financial sector and real (industrial) sector
- Industrialization started when global financial flows were very limited

ASEAN

- Industrialization in which **foreign enterprises played the major role of establishing new industries** under the policies of financial liberalization and trade liberalization
- Industrialization started when global financial flows increased

Comparison between Far East Asia Model and ASEAN Model: (2) Risks of investment in new industries

Far East Asia

- Risks of investment in new industries were too large for private financial institutions alone to take
- Government shared a part of risks of investment in new industries to reduce the risks for private financial institutions

ASEAN

- As foreign enterprises had rich experiences, risks of investment in new industries were smaller

Comparison between Far East Asia Model and ASEAN Model: (3) Difficulties in evaluation and monitoring of investment

Far East Asia

- Private financial institutions had not sufficient capacity of evaluation on profitability and risks of new industries
- Government or **government financial institutions** evaluated **profitability and risks of new industries** on behalf of private financial institutions

ASEAN

- Evaluation on investment was not practically necessary because **foreign enterprises with rich experiences made investment**

Comparison between Far East Asia Model and ASEAN Model: (4) Difficulties in providing long-term finance

Far East Asia

- Long-term financial resources were introduced by policy-based finance of government, or government financial institutions

ASEAN

- Foreign enterprises were able to obtain long-term finance from overseas

- The above comparison is based on Okuda, Hidenobu. 2000, *Financial System in ASEAN: Direct Investment and Development Finance*, Tokyo: Toyokeizai, p.43 (partially modified by the author)

4. Far East Asia: Lessons learned

- The **policy-based financial institutions** not only provided **low-interest-rate loans**, but were also instrumental in **preventing disorder in the finance sector**, which can be common in developing countries due to poor monetary policy. Hence, these Far East governments supported a number of policies to avoid such problems.
- The **government committed resources** to investment projects as a measure against financial institutions' weak risk diversification. The market took this move as a **tacit signal of a guarantee** for a project's success. This demonstration of the government's commitment made it easier to invest in new industries.
- Moreover, policy-based financial institutions **provided the screening services** which private financial institutions often lacked. In other words, the government's commitment was understood as justification for investment, and so private financial institutions left screening to the government to avoid problems. So in the end, **while the underdeveloped financial sector could not provide adequate long-term funding**, government-affiliated financial institutions artificially supplemented the shortage.

The case of Japan

- Japanese public development financial institutions depended on government fiscal investments and loans as a source of funds. These investments and loans were primarily funded by **postal savings and pension premiums**.
- The Japanese public development financial institutions were able to make a significant contribution to the **development of selected industries which were central to industrialization**.
- During the social and economic upheavals (e.g. reluctance by banks to lend, earthquakes and oil price hikes), government affiliated financial institutions offered emergency loans and set credit lines, **providing a financial safety net**.
- Compared to other countries, Japan's policy-based finance was sizable and leaned toward direct finance.

The Case of Korea

- The financial system in South Korea had long been regulated by the government. In 1961, private banks were nationalized, and the government used commercial banks as a tool to promote its development plans. Between 1973 and 1981, **policy-based finance was heavily used**, accounting for about 60% of all loans rendered by South Korean savings banks. **It bolstered exports and promoted industrialization by funding specific industries at low interest rates.**
- However, while loans remained accessible to large corporations, including business and financial conglomerates (chaebol), they were **not sufficiently available to small and medium enterprises. As a result they turned to informal lenders, who charged high interest rates.**

5. Public financial institutions in ASEAN countries focused on SMEs and agriculture

Thailand

- Industrial Finance Corporation of Thailand (IFCT)
- Small Industry Finance Corporation of Thailand (SIFC)
- Small Industry Credit Guarantee Corporation (SICGC)
- Rediscount Facility of Central Bank
- Board of Investment (BOI)
- Department of Industrial Promotion (DIP)

Malaysia

- Credit Guarantee Corporation (CGC)
- Bank Pembangunan dan Infrastruktur Malaysia Berhad
- Bank Industri Malaysia Berhad
- Malaysian Industrial Development Finance Berhad
- Small and Medium Industries Development Corporation (SMIDEC)
- Benchmark of Banks' credit allocation to SMEs

Source: JBIC, 2001

- In Thailand, commercial banks were important financial sources for automobile, textile and sugar industries. (Doner, 2009)

Case 1 : Thailand automobile industry: Eastern Seaboard, Detroit of Asia and Beyond

- Production of 1 million cars achieved in 2005 and **2.5 million cars to be achieved in 2012**
- It is estimated that there are about **640 first layered parts maker and 1700 second and third layered parts makers** supporting the automobile industry

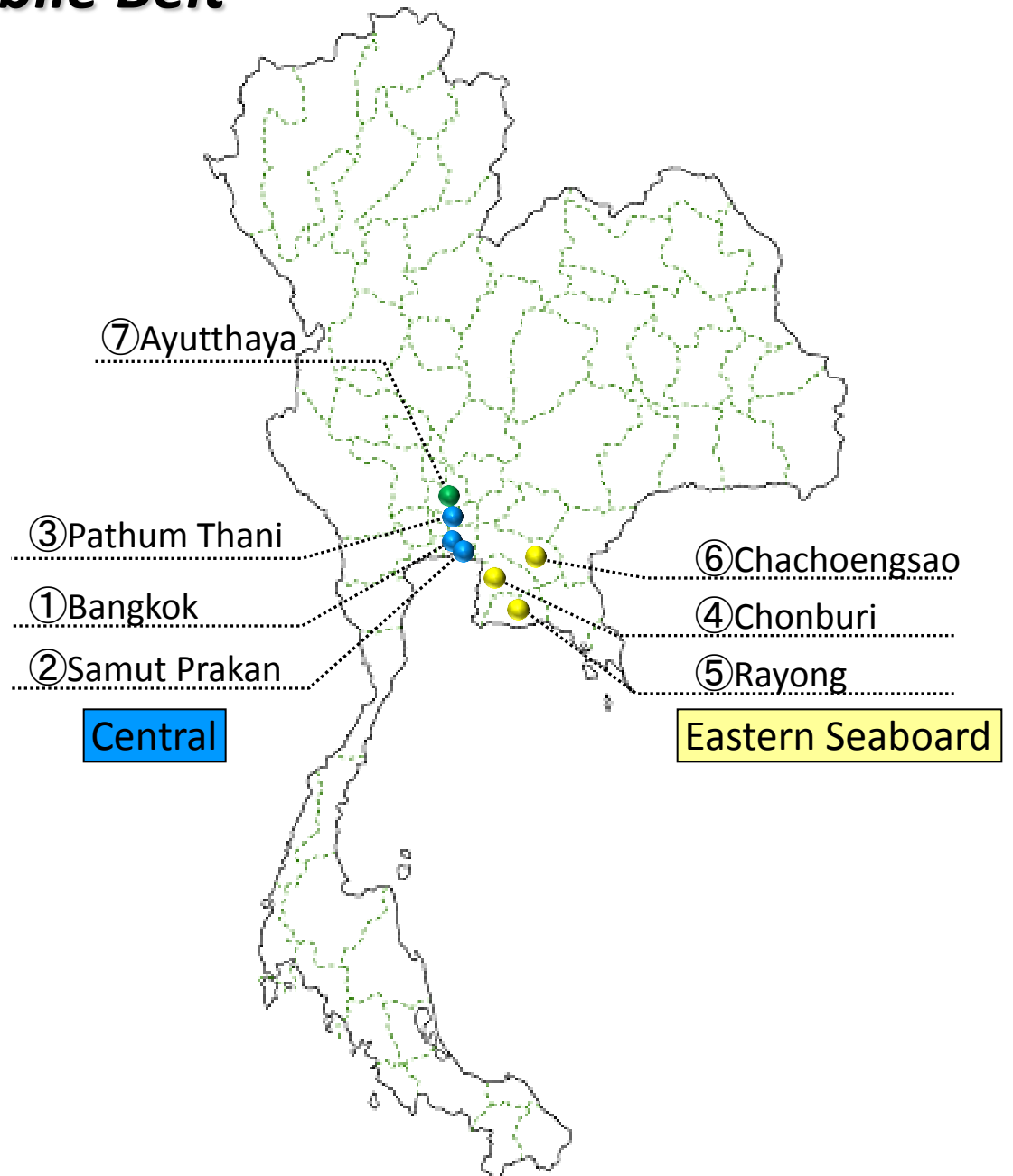
Accumulation of Knowledge and Capabilities, and of Supporting Industries

- Development of an automobile industry requires skilled labor and supporting industries to provide up to **20,000 to 30,000** parts and components. Supporting industries and automobile assembly plants are closely related and provide externality to each other.
- Among several policy measures, a series of initiatives by the Thai government to incrementally enhance the localization of parts production was important for the accumulation of knowledge and capabilities of **supporting industries**.
- Techakanont (2008, p.8) considers that “the most important policy of the Thai state was the implementation of the LCR (Local contents requirement).”
- Yamashita (2004, p.5) “the **process of adaptation to the LCR enabled the accumulation of a very wide range of automobile parts industries and formation of skilled technicians and engineers...**”

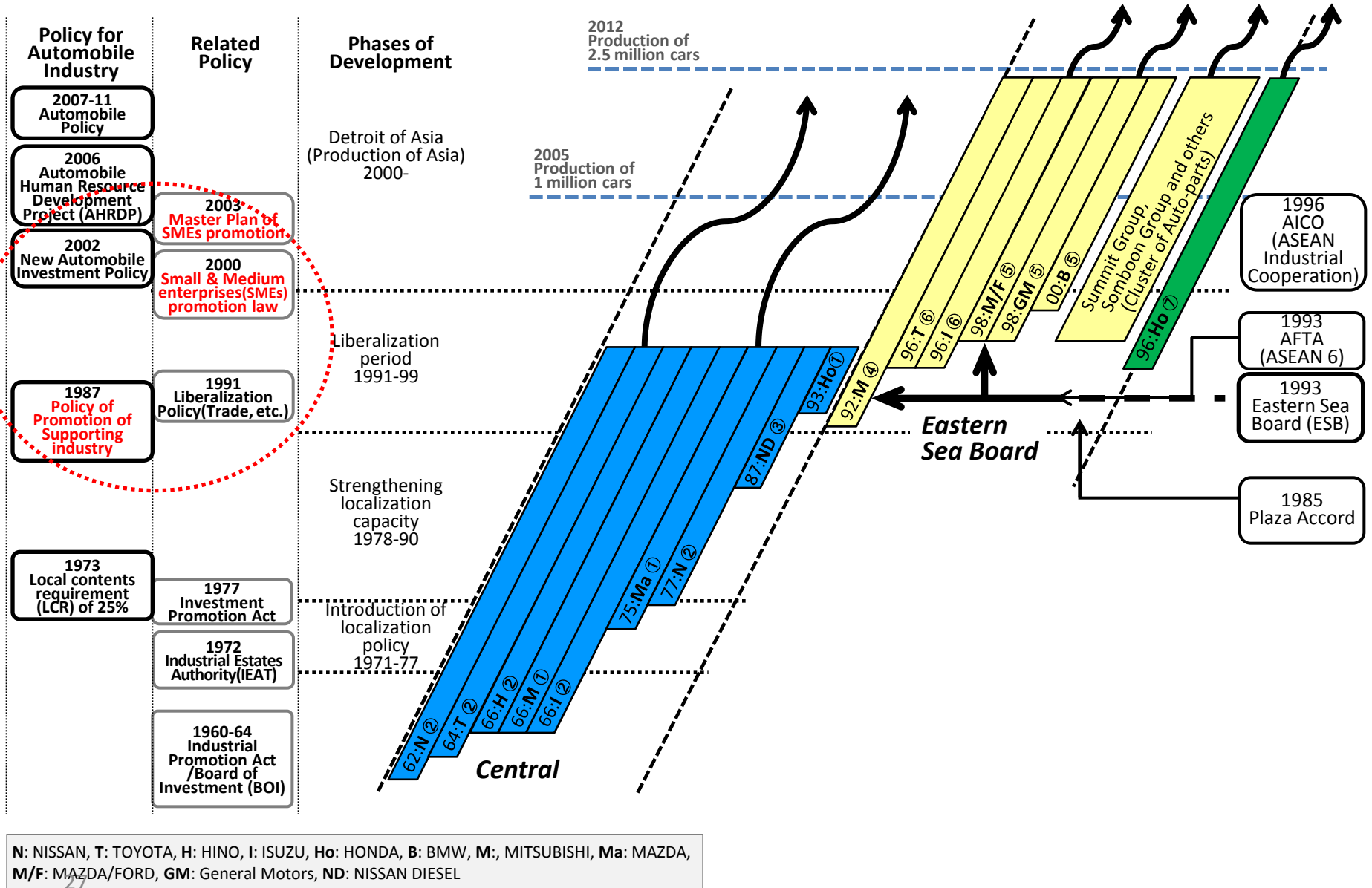
“Detroit of Asia” and Eastern Seaboard in Thailand

- The Eastern Seaboard Infrastructure created an export hub and the center for technology-intensive industries: 14 industrial estates; 360,000 workers; 1,300 factories; and 516 automobile-related factories.
- Today, Leam Chabang is Thailand's largest port and plays a significant part in increasing trade in Thailand, and is where Thailand's automobile industry is most heavily concentrated, with many automakers' and parts manufacturers' operations set up in the area.
- The Thai government introduced the **New Automobile Investment Policy in 2002, which aimed to develop Thailand into a regional center of the automobile industry in Southeast Asia**. Two years later, a further automobile development plan was introduced, the so-called **“Detroit of Asia”** plan, which was later renamed the **“Production of Asia”** plan.

Thai Automobile Belt



Development of Automobile Industry in Thailand





① The Eastern Seaboard at Rayong became a 'Detroit of the East' as a few global manufacturers set up factories there to make pick-ups



② New Mitsubishi Motors Thailand production 'Mirage'



③ Auto plants in Thailand include Ford-Mazda AutoAlliance (center) and GM behind it



④ Honda Thailand announced to build a second assembly & engine plant (2013)



⑤ Factory workers

Thailand invested in agriculture and agroindustry as well

- The strategy that Thailand adopted in the 1980s is typical of a Newly Agro-Industrialising country (NAIC).
- The NAIC strategy became part of Thailand's Sixth Economic Development Plan (1986-91), and aimed at establishing Thailand as a net exporter of food as a basis for industrialization. It encouraged the development of agro-industry as an export industry based on its past achievements of exporting primary products and for their diversity.
- This policy demonstrated that the **agro-industry**, through processing and value addition to agricultural products, **can play as a driver to economic growth.**

- Specific support measures adopted by the government for the industry included provisions for **preferential investment for the agro-industry (Bank of Agriculture and Agricultural Credit Association) and flexible financing for the agriculture-related sectors by commercial banks.**
- However, these policies just expanded on initiatives that had already set in place since the 1970s. It is more appropriate to say that development of the agro-industry in Thailand was rather driven by the private sector than the government.
- Other factors that contributed to the expansion of the agro-industry include: (1) **More sophisticated infrastructure**, including roads for transport of products and forest clearance; and (2) **Integration of near-subsistence farmers into the cash economy** as they sought the means to earn cash income.

In Malaysia, Vendor Development Program developed supporting industries

- Malaysian Government sought to develop supporting industries through **the Vendor (local parts suppliers) Development Program**. This program had a number of goals. Firstly, it sought to make local Malaysian companies the suppliers and manufacturers of the industrial intermediate goods, machinery and equipment used by large and multinational companies.
- Moreover, it aimed to create and **strengthen linkages between different size firms and financial institutions**. Local large and multi-national companies, referred to as anchor companies, not only supplied vendor companies with the appropriate machinery and equipment but they also provided economic and managerial advisory services.
- Later a Tripartite Agreement system was introduced between the Ministry of International Trade and Industry (METI), **anchor companies and financial institutions** in an attempt to strengthen cooperation between small and medium companies and large or multi-national companies through coordination by METI. Source: JBIC/JICA, 2008

- Additionally, in support of the private sector and local capital, a **project to finance Bumiputra small and medium enterprises was implemented** and a new investment fund was created.

In Indonesia, a resource rich country, Dutch disease was avoided

- Indonesia spent much of its **oil revenue** on **infrastructure, social services, agriculture and the manufacturing sector**.
- Particular focus for investments was placed on **tradable-goods** within the manufacturing and agriculture sectors.
- While these goods may be vulnerable to Dutch disease in the long-term, **Indonesia succeeded in bolstering its production base** as well as maintaining and expanding exports through improved productivity and supply capacity.

In Indonesia, a natural resource rich country, investment in agriculture was one of the main priorities

- Using earnings from oil and mineral resources made vital contributions to agriculture and rural development, providing a basis for long-term economic growth
- Effectively combining supply-side support measures with (high quality seeds, chemical fertilizers, irrigation infrastructure and agricultural finance) and demand-side support measures (producer price support in the improvement of agricultural productivity, etc.) proved crucial for success

Table: Trends in Irrigation Development in Indonesia

(Unit: 1,000ha, a billion rupiah)

| | 1969-74 | 1974-79 | 1979-84 | 1984-89 | 1989-94 | Total |
|---|---------|---------|---------|---------|---------|----------|
| Area | | | | | | |
| Rehabilitation of irrigation facilities | 957.8 | 513.5 | 320.7 | 401.3 | 2,328.4 | 4,521.7 |
| Expansion of irrigated area | 171.2 | 255.5 | 369.8 | 218.4 | 500.0 | 1,514.9 |
| River improvements/Flood protection | 286.6 | 431.1 | 387.9 | 442.9 | 450.0 | 1,998.5 |
| Reclamation of wetlands | 199.6 | 218.6 | 438.9 | 191.9 | 444.2 | 1,493.2 |
| Total | 1,615.2 | 1,418.7 | 1,517.3 | 1,254.5 | 3,722.6 | 9,528.3 |
| Development budget allocation | | | | | | |
| Rehabilitation of irrigation facilities | 50.0 | 144.0 | 416.4 | 261.7 | 2,287.6 | 3,159.7 |
| Expansion of irrigated area | 25.0 | 195.7 | 658.4 | 417.3 | 3,112.7 | 4,409.1 |
| River improvements/Flood protection | - | - | - | 329.9 | 919.7 | 1,249.6 |
| Reclamation of wetlands | - | - | - | 74.8 | 939.1 | 1,013.9 |
| Others | 39.4 | 204.9 | 588.7 | 3.7 | 111.8 | 948.5 |
| Subtotal | 114.4 | 544.6 | 1,663.5 | 1,087.4 | 7,370.9 | 10,780.8 |

Lessons learned from experiences in South East Asia

- Industrialization and economic transformation were essential for inclusive development, especially for generating 'good' jobs (in terms of WDR 2013)
- Large industries were financed by FDI and related external finance
- SMEs and agriculture have been, generally, financed by public financial institutions and local commercial banks. These sectors have been crucial for inclusive development

● **Table: Scale of Policy-Based Finance in Four Advanced Nations (excluding housing)**

| | US | UK | Germany | France | Japan |
|---|---------------------|---------------------|--------------------|--------------------|--------------------|
| Size of Policy-Based Finance | 530 billion dollars | 54.1 billion pounds | 338.8 billion euro | 123.4 billion euro | 98.3 trillion yen |
| Percentage Against Nominal GDP | (5.4%) | (5.7%) | (16.7%) | (8.7%) | (19.1%) |
| Total Including the Credit Guarantee for Small- and Medium Businesses | 564 billion dollars | 54.5 billion pounds | 343.7 billion euro | 128.5 billion euro | 139.7 trillion yen |
| Percentage Against Nominal GDP | (5.7%) | (5.8%) | (17.0%) | (9.1%) | (27.2%) |

Note: This table summarizes the credit loan activities that involve the central government. (The data does not include private housing.) The data on Germany include financial institutions at the Province level, which are categorized as Special Banks (policy-based financial institutions). UK's loan indicates the balance at the end of March. UK's credit guarantee for small- and medium companies indicates the balance at the end of March 2001. Both data on Japan indicate the balance at the end of FY2000. The rest of the data indicate the balance at the end of 2000.

Source: Koike, Takuji (2006). "Reform of the Policy-Based Finance—Progress and Issues," Research and Information Vol. 534. National Diet Library

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