

# **Economic Resilience Capabilities and long term Growth in Developing Countries**

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## Introduction

A vast array of economic literature examines the complex nature of growth: its stimulants as well as constraints. For instance, Easterly and al. (1993) argue that shocks, and to some extent luck, explain growth differential much better than the quality of policy or institutions. Nevertheless, Development theory, and the experiences of the last 50 years, have demonstrated that structural change has been the main engine of long-term catching-up processes. In a review article, Syrquin (1988) noted that “*economic development is seen as an interrelated set of long-run processes of structural transformation that accompany growth*”. However, structural change, often accelerated by international trade and regional integration, increases the vulnerability of an economy. In addition, trade openness exposes countries to the spillovers of crises triggered elsewhere. Thus, at national level, the aptitude to adjust to shocks and to minimize growth losses is a major factor of development performance and growth sustainability. Economic resilience depends on domestic capabilities to design, implement and support corrective and adaptive measures. Although shocks are crucial in determining growth path, the magnitude and the nature of their impact on catching-up process and long-term growth varies among countries. As Berg and Ostry (2011) puts it, “*growth is easy to start, hard to keep going*”.

This paper argues that the ability to adjust to external shocks is a key explaining factor of long-term growth differences in the developing world, notably the success of most developing countries in Asia. Part I draws the analytical framework, based on the role of social cohesion and State effectiveness. Then, specific indicators for these two notions are provided for a large sample of developing countries (DC). Thus, Part II presents empirical evidences on economic resilience capability at works. This comparative analysis shows that, while South-East Asian economies are a diverse group, most of them have a strong ability to sustain growth for long periods of time.

## **1/ Issue and analytical Framework**

### **1.1 Openness, shocks and fast development**

Increasing economic openness in the developing world have amplified domestic economies exposure to external conditions and changes. Integration in the global economy can stimulate the catching-up process and provide opportunities for growth acceleration. Yet, openness does as well amplify a country vulnerability to external shocks. Shocks like rapid change in terms of trade, exchange rates, debt and financial crisis, etc. will always be the collateral effects of an international integration strategy. These shocks provoke changes in domestic income and wealth distribution, new gains and losses, that stimulate conflicts and threaten the country's stability. This outcome may deepen the negative impact of external shocks on the domestic economy. Their probability and their frequency increase with the degree of economic openness.

Because economic development is a process of structural change, faster are the changes and quicker is the development rythm. The countries that can sustain multiple transitions across different stages of structural transformation grow successfully. The multiplication of shocks on economic structures can speed up the growth process (Hirschman; Schumpeter). Anyhow, structural change is a conflictual process : *"Economies do not grow smoothly and evenly, maintaining their shape as they increase their size. Instead, fast-growing economies go through a tumultuous process of creative destruction, breaking into new industries even as they abandon their traditional industrial strongholds"*<sup>1</sup>. As a consequence, the sustainability of development strategies based on international integration requires sufficient domestic absorbtion and adjustment capabilities. Lack, or weakness, of such capabilities make countries too vulnerable to external shocks and unable to benefit fully from the gain of global integration. Without these complementary capabilities, DC risk to get too much of the pain and too little of the gain of international integration.

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<sup>1</sup> *The Growth Report, Strategies for Sustained Growth and Inclusive Development*, Commission on Growth and Development 2008, p 26.

## **1.2. Economic resilience, a key factor of development performance**

The first argument of this paper is that shocks may accelerate the structural transformation in backward economies. However, the direction and the scope of their impact on growth – their “net” effect- depends on the country ability to absorb, to adjust and to recover from these shocks. This absorption capability is a critical component of any international integration strategy. In countries with deep social division, for instance high levels of economic, ethnic or regional inequality, shocks on income or resources distribution will fuel potential social conflicts and may deepen the recession and the structural weaknesses of the domestic economy (Attanasio, 2004; Berg and Ostry, 2011; Collier, 2008 ; Rodrik, 1999). Countries with a weak or inefficient State will have great difficulties to manage both the economic and the social costs of these shocks and their redistributive consequences. They will also lack the capacity to design and to implement the appropriate adjustment policies. In such cases, structural adjustment is delayed. It may be imposed later by external institutions. Adaptive measures in trade policy, fiscal and budget policy, relatives prices and exchange rate management, are not easily undertaken because of the potentially high cost of distributional conflicts. In the worst cases, economic paralysis may turn into economic collapse and the disintegration of domestic institutions. Thus, the domestic aptitude to adjust to shocks and to minimize growth losses is a major factor of development performance and sustainability. But where do the domestic capabilities for policy adjustment and economic resilience come from ? How do all the aforementioned institutional factors affect economic resilience and ultimately economic growth?

## **1.3. Key concepts: Social Cohesion & State Effectiveness**

For a given level of income, a country’s economic resilience capability depends on its social organization and on its government institutions. One way to analyze some of the social forces at work in development is through the concept of social cohesion, which is derived from the debate on social capital. There is an agreement among sociologists, political scientists and economists that social capital is specific in that it is relational : It exists only because it is shared. However, the debate is still vigorous on the precise definition and the empirical use of social

capital (Ponthieux 2006). Hence the value of the more precise concept of “social cohesion” to study the impact of social relations on the development path. Chan et al. (2006) define social cohesion as follows: “*social cohesion is a state of affairs concerning both the vertical and the horizontal interactions among members of a society, as characterized by a set of attitudes and norms that include trust, a sense of belonging, and the willingness to participate and help, as well as their behavioural manifestations*”. For the practical purposes of this paper, social cohesion will refer to the institutions, relationships, and norms embedded in the social structures of the society that shape the quality and quantity of the social interactions. Social cohesion does not refer only to the sum of the institutions and norms which underpin a society, it is the glue that holds groups and societies together (Narayan 1999). As social cohesion is an attribute of the social structure, it has public good characteristics.

Turning to the State, a vast sum of research has shown that an efficient State is critical for the growth and development process<sup>2</sup>. State effectiveness is defined here as the capacity of government institutions to design and to implement development policies and adaptative measures. The concept of effectiveness refers to the extent to which the development policies objectives were achieved, taking into account changes in the economic environment. This aspect refers to the competence, authority, and resources of government organizations. The effectiveness of government depends firstly on the talent it can attract, the organizational structures it imposes and the incentives it fosters. But the strength and the quality of government institutions do not depend only from the State apparatus, but also from a set of social relations, bureaucratic practices and institutional routines which establishes social order. Social cohesion, public policies and government institutions are not independent. The structures, norms and routines of the State are in interaction with the social structures and behaviors. Social cohesion has an impact on the overall governance environment and the effectiveness of government institutions, and the State’s characteristics and government practices influence social cohesion. We consider here an ideal State while, of course, in practice the State behavior is often oriented towards the interest of specific groups. In the East Asian

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<sup>2</sup> From Myrdal, “Strong State”, to Chalmers Johnson, “Developmental State”, to the relatively recent, but growing, importance given to the quality of government institutions in World Bank WDR reports (1993, 1997 “*The State in a changing world*”, 2002, 2003, 2004).

case for instance, a large body of literature has analysed the various nature of the State<sup>3</sup> and it has notably shown that State effectiveness is not clearly linked to the degree of autocracy/democracy.

Thus, under conditions of good governance, the efficient State complete and strengthen informal interactions and coordination between social groups. While ex-ante these institutional capabilities are difficult to identify and to measure, ex-post we can easily appreciate their outcome.

#### **1.4. Central idea of the paper**

Why some DC experienced a drop in their growth when they are exposed to external shocks while growth losses are very limited in others countries? This paper argues that State effectiveness and social cohesion are a key to understanding differences in economic resilience between developing countries. We insist on the interaction between these institutional factors and the distributive impact of shocks to explain growth collapse and the length of recessions. The central idea in this paper can be summarized by the following formula :

$$(1) \text{ Economic Resilience} = (\text{State Effectiveness}) \times (\text{Social Chesion})$$

$$(2) \text{ Growth Loss} = - (\text{Shock}) / (\text{Economic Resilience})$$

In words, the negative effect of shocks on a country growth is stronger in a country characterized by less effective government institutions and a weaker social cohesion.

The interpretation is as follows. A shock reduces the domestic economic resources and modifies the income distribution. The larger the shock, the higher the income loss. Thus, all social groups can not keep stable their income. Potentially asymmetric income losses will create rivalries between groups, which may take the form of social conflicts. In such a case, the cost of the shock increases and the country's economic performance fall down. The resulting social conflict generates a cumulative process of domestic instability which may possibly prevent significant economic recovery for a long time.

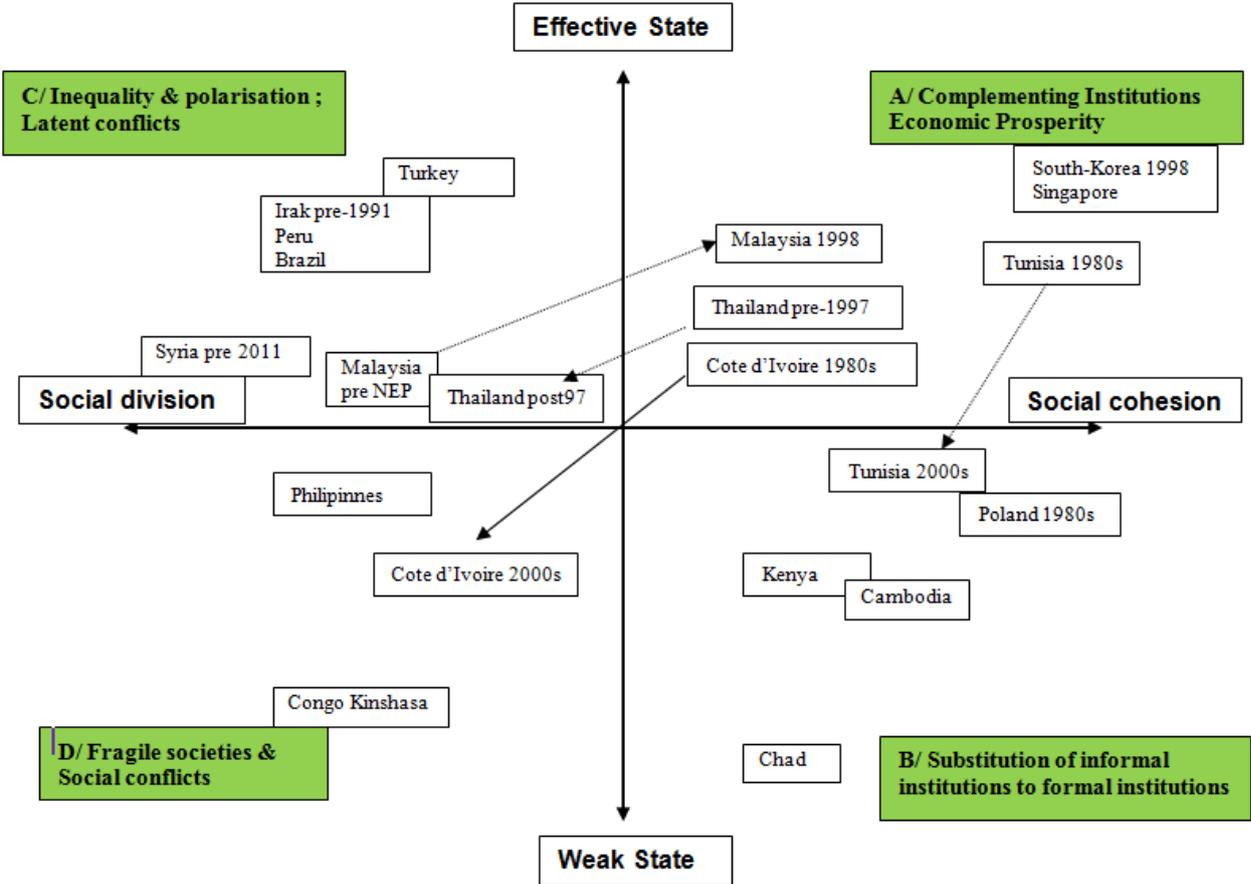
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<sup>3</sup> Croissant and Bünte (2011); Croissant and Wurster (2013); Morlino et al (2011).

When social cohesion is sufficiently strong, opportunistic behavior is less frequent and social rivalries are less intense. Thus, there is a lower probability that the change in income distribution will generate social instability and domestic conflicts. When the State's authority is effective, change in distributional outcomes will be less sensitive to social demands and conflicts. In addition, an effective State will be able to manage distributional outcome inequities and to implement adaptative measures and economic recovery policies. On the other hand, when social cohesion is weak and the State ineffective, there are more incentives to adopt an opportunist behavior because income rivalries are not moderated by the unformal (social cohesion) or more formal (government institutions) rules that govern the ex-post distribution of income. As a consequence, social conflict returns increase.

**1.5. A simple analytical framework**

Figure 1 : Economic Resilience Map



This simple analytical framework is helpful in understanding differences in economic resilience because it captures the key determinants of domestic absorption and adjustment capabilities to shocks. The two critical dimensions alongside which countries evolve on this map are : i) the level of the State effectiveness and ii) the degree of social cohesion (figure 1). In the best case (A : quadrant North-East), effective government institutions are complemented by a high level of social cohesion which lead to robust economic and social structures. Countries that belong to this group are characterized by a high potential for development and, more specifically, by a strong capacity to manage both the opportunities and the risks which are associated with openness. This group include Singapore, post-1962 South-Korea or pre-2000 Tunisia<sup>4</sup>. The relative absence of crime, violence and domestic conflicts is a testimony to high levels of social cohesion in these countries. In Asia, the Korean or Singapore State, or in North-Africa Tunisian effective government, have often been celebrated as exemplary models for other DC by international organizations<sup>5</sup>. In societies characterized by a high density of social links and social cohesion and poorly functioning State (B quadrant South-East), non-governmental and informal institutions are substitutes for coordination processes, collective rules and social norms production and diffusion. It explains for instance why informal credit arrangements (tontines) and micro-finance programs can be prosperous in this group of countries<sup>6</sup>. In the case of a weakening of the informal institutions capacity, social conflicts increase and the countries may move to the quadrant South-West (D).

On the opposite, countries may also be characterized by the combination of an effective, a “strong”, State and a high level of social fragmentation (C : quadrant North-West). In most of these cases, governing institutions are under the exclusive control or influence of one dominant social group, leading to various discriminations based on ethnic, religious, cultural, economic or regional differences. Countries wich followed discriminating policies against indigenous populations (such as Peru,

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<sup>4</sup> The stabilizing power of social cohesion in a crisis context has been illustrated by post-revolution reactions in Tunisia (in 2011). Until now, tensions caused by the political transition have been far less violent in Tunisia than elsewhere and a new institutional (and democratic) order is under implementation in 2014-2015, successfully so far.

<sup>5</sup> For instance, the World Bank “*World Development Report 1997 - the State in a changing world*” insisted on the virtues of the Korean bureaucracy.

<sup>6</sup> Bangladesh is a good illustration : A country with a very poor state and where Gramesh is born.

Bolivia) or which are characterized by high income inequality (such as Brazil) belong to this category. An extreme case of a country belonging to this group could be Iraq under Saddam Hussein rule. In such an institutional pattern, social rivalries and latent social conflicts are very acute. These conflicts may surface and degenerate into violence and civil war if the State becomes weaker (post-2011 Syria), or because of growing inequity, due to the disproportionate impact of an economic shock on discriminated groups income. These groups may eventually organize social and political movements that challenge the government power. Hirschman compared this process to a two-lane traffic jam. If one lane begins to move, drivers in the other at first take comfort, inferring that their lane will also move soon. But the longer they remain stuck, the more frustrated they will be and the other lane becomes a provocation<sup>7</sup>. The social conflict may further evolve into pre-revolutionary stage and beyond. If political changes lead to more social integration and less inequality, societies may become more prosperous and eventually move into quadrant North–East (A). Alternatively, they may degenerate in a permanent or prolonged conflict pattern, that will erode the remaining State capacity. As the State ceases to fulfill its functions, and in the absence of sufficient social cohesion, power and authority may be taken over by various groups, with the use of violence and coercion; Control over political and economic resources may become subject to armed conflict (D : quadrant South-West). Diverging trajectories of East-European countries, after the collapse of the communist States and the shock of economic transition, illustrated the influence of social cohesion on the alternative move in the A or D direction; The cohesive Polish society for instance performed much better than the fragmented Yugoslavia. Countries location on the map are not static. They can change because of institutional, social or economic development, war,...

## **2/ Empirical evidences: South-East Asia among the Developing World**

### **2.1 Economic Resilience and long term growth gaps**

Growth in Cote d'Ivoire has been on average four points slower than in Thailand every year since 1980. As a result, the Thai GDP/capita has become three times

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<sup>7</sup> A.O Hirschman (1981). "The Changing Tolerance for Income Inequality in the Course of Economic Development," in *Essays in Trespassing*. Cambridge, UK: Cambridge University Press.

bigger than the Cote d'Ivoire level in 2010, while it was only half in 1980<sup>8</sup>. Such a growth gap is usual when African experiences are compared with Asian performances. Many studies have documented the role of trade, structural change, manufacturing growth, education and investment, etc. to explain the very fast growth of Asian countries. They conclude that growth, both absolute and relative, has been fast in Asia because it was led by powerful engines, firstly investment (Krugman 1994, World Bank 1993).

In the former explanation, as in traditional development studies, growth stimulation is key in explaining average differences between countries. Thus, the policy debate focus on the possible ways to increase the potential growth rate. We insist here on another cause of long term variation in growth trends between developing countries : the different capacity of national economies to cope with shocks and to recover from a recession, ie : differences in economic resilience. A few papers have recently focused on the causes of the persistence of growth process and/or on economic resilience. Bourguignon (2004) observes that in a number of studies, inequality plays a central role in determining the rate and the pattern of growth. Berg and Ostry (2011), for instance, show that the duration of "growth spell" was associated with more equality in the income distribution, while Hausmann et al (2006) investigate the factors associated with growth deceleration and demonstrate that the country's structure of export is associated with lower crisis duration. These contributions illustrate that growth differential on long period does not result only from disparity in growth speed during the phases of expansion but also from the limitation of growth losses during and after recessions. In other words : A large part of the growth differential between growth champions and laggards results from diverging post-crisis performances.

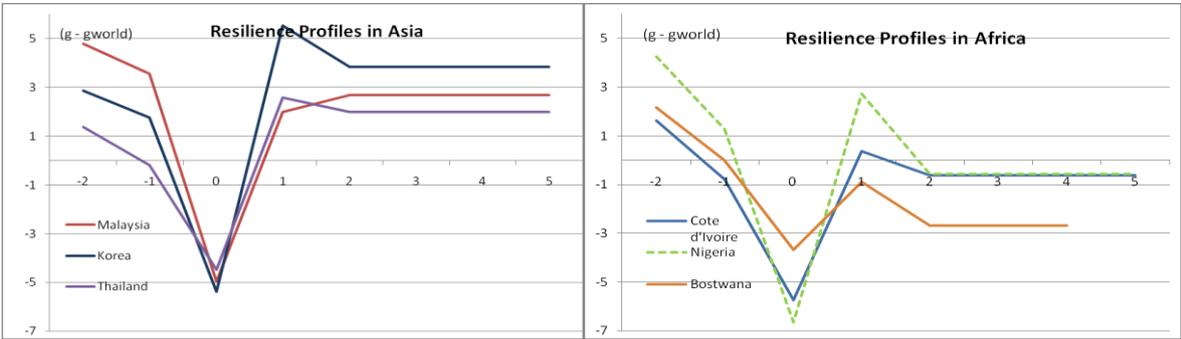
To illustrate the different impact of shocks among countries, we draw "Resilience Profiles" in Asia and in Africa, on the basis of their post-crisis experiences from 1970 to 2009 (figure 2). For each country, we have calculated an average crisis profile : To neutralize the change in the international growth regime, we define a recession as a growth rate falling below the world average  $g_w$  ( $y=0$ ); For every

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<sup>8</sup> In constant 2005 \$.

recession ( $t= 0$ ), we compute  $t-1$  and  $t-2$  growth rates (“pre-crisis” period),  $t+1$  rate (“recovery” time) and the average growth rate from  $t+2$  to  $t+5$  (“post-crisis” period). While the scale of the recessions are similar in both groups here (growth rate falling around  $-5\%$ ), post-crisis sequences are diverging. Asian countries recovery has been fast and sustainable : growth becomes positive in  $t+1$  and remain strong in the following years ( $+2$  to  $+4$  points above the world average). In Africa, a growth rebound in the short-term ( $t+1$ ) has not led to a stable expansion in the mid-term.

**Figures 2 : Resilience Profiles**



After a recession, average recovery time<sup>9</sup>, amounts to 1,25 year in Korea, 1,6 year in Malaysia and Thailand, but 3,2 years in Nigeria and 5,2 in Cote d'Ivoire! Recessions provoke growth collapses in Africa. Thus, a large part of the expansion gap between countries results from the length of recession, ie : difference in economic resilience. The 4.1 points average annual growth gap between Thailand and Cote d'Ivoire since 1970 is the sum of growth speed difference with Thailand, when the African economy was in expansion, plus difference in growth “lost” during the recession periods.

To show the impact of the length of recessions, and of the related growth losses, on long term development, we compare growth gaps in a large sample of DC during the last three decades (1980-2010)<sup>10</sup>. Since China has been the fastest growing economy during this period ( $+9,8\%$  / year), we define a “growth gap” as the difference between the country “i” average annual growth rate,  $g_i$ , and China's.

<sup>9</sup>Delay to reach half of the pre-crisis expansion growth rate, (Primary data from WDI database).

<sup>10</sup> Our sample include 57 DC, for which enough data were available.

Then, we present the structure of the growth gap as the sum of (a) growth speed difference with China + (b) growth losses. The first term is the cumulated difference of growth speed with China when the economy “i” is in expansion ( $g_i > g_w$ ); the second term is the cumulated growth lost during economy “i” recessions ( $g_i < g_w$ ).

growth gap = (a) growth speed difference + (b) growth losses during recessions

Table 1 : Growth gaps structure

| Country / Region         | Growth gap (points) | Structure of the gap |               |
|--------------------------|---------------------|----------------------|---------------|
|                          |                     | Speed difference     | Growth losses |
| <b>MENA-Central Asia</b> | <b>5,8</b>          | <b>67%</b>           | <b>33%</b>    |
| <b>Sub-Sahara Africa</b> | <b>6,5</b>          | <b>57%</b>           | <b>43%</b>    |
| <b>South-Asia</b>        | <b>4,7</b>          | <b>91%</b>           | <b>9%</b>     |
| <b>South-East Asia</b>   | <b>3,9</b>          | <b>88%</b>           | <b>12%</b>    |
| Singapore                | 3,0                 | 93%                  | 7%            |
| Thailand                 | 4,4                 | 84%                  | 16%           |
| Malaysia                 | 3,9                 | 88%                  | 12%           |
| Indonesia                | 4,3                 | 86%                  | 14%           |
| Philippines              | 6,4                 | 63%                  | 37%           |
| Vietnam                  | 3,5                 | 100%                 | 0%            |
| Lao PDR                  | 3,5                 | 91%                  | 9%            |
| Cambodia                 | 2,2                 | 100%                 | 0%            |
| <b>Latin America</b>     | <b>6,7</b>          | <b>54%</b>           | <b>46%</b>    |
| Argentina                | 7,2                 | 48%                  | 52%           |
| Bolivia                  | 7,1                 | 49%                  | 51%           |
| Brazil                   | 7,1                 | 49%                  | 51%           |
| Chile                    | 5,0                 | 81%                  | 19%           |
| Costa Rica               | 5,8                 | 74%                  | 26%           |
| Ecuador                  | 6,7                 | 60%                  | 40%           |
| Nicaragua                | 7,8                 | 36%                  | 64%           |
| Paraguay                 | 6,0                 | 67%                  | 33%           |
| Peru                     | 6,5                 | 56%                  | 44%           |
| Uruguay                  | 7,3                 | 47%                  | 53%           |
| Venezuela                | 7,7                 | 31%                  | 69%           |

Source : Author’s calculation based on a 57 DC sample

This very simple growth accounting illustrates that average growth divergence between countries is strongly influenced by differences in economic resilience capacity. If we consider the “growth losses” component of the gap as a proxy for the lack of resilience, then this element accounts for one third of the growth difference for MENA-Central Asia and one half for Sub-Sahara Africa (SSA) and Latin-America

(Table 1). Intra-Regional differences have been important in both regions. In Venezuela, Brazil or Argentina, the growth gap with China is firstly explained by the lack of resilience. In African countries such as Togo, Gabon, Niger, Cote d'Ivoire, Central African Rep, Madagascar, South Africa<sup>11</sup>, between 50% and 75 % of the long term growth divergence is due to the same cause, the length of recessions. In comparison, economic resilience has been stronger in S-E Asia, as well as in South-Asia, where growth losses have only contributed to, respectively, 12% and 9 % of the growth gap with China.

In Asia, growth rates have been high on average but not stable. Asian economies went through several periods of slowdown and experienced rare contractions. The number of recessions varies with the definition of recessions. According to Kaminsky and Reinhart (1998), between 1970 and 1995 Latin-America countries suffered 50% more crises by country than East-Asia. Hong et al (2009) observe a duration of recessions in Korea and Malaysia 40 % shorter than the world average. The strong resilience capacity in the region was clearly illustrated during the worst regional crisis, initiated by the devaluation of the Bath on July 2, 1997: GDP fell by 7,4 % in Malaysia, 10,5 % in Thailand, 13 % in Indonesia in 1998. Then, all SEA countries recovered positive, albeit lower, growth rates in 1999. The 2008-2009 global financial crisis impact was similar : S-E Asia industrial production fell strongly in the last quarter of 2008 and growth rates became, on average, negative in 2009. However, contrary to many expectations, Asian economies experienced, again, a “V” shaped recovery. Expansionary monetary policies and ambitious stimulus packages strongly contributed to reduce the crisis amplitude (Hong et al 2010).

## **2.2 Social Cohesion and State Effectiveness index**

Statistical assessment of the effectiveness, or of the “Strength”, of the State is difficult. Data, ranking, and index have been provided in numerous papers to try to figure out the quality of the governance, or of the State’s administration, such as the “Government effectiveness” index from the World Bank Worldwide Governance Indicators (WGI) database or the State’s capacity indicators from the Institutional

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<sup>11</sup> Data on African countries not reported here, but available for 21 countries.

Profil Database (IPD). These indicators are built, partially or totally, upon opinions and marks given by experts and expatriates on different institutional issues in the corresponding country. Thus, they are often biased, not reliable and not robust<sup>12</sup>.

We use a different strategy here. We posit that the State main (economic) function is to provide public goods. Thus we define the State effectiveness as the capacity to provide these public goods and services. To evaluate it, we build a Public Goods Provision (PGP) index. The PGP index is a summary measure of average achievement in three key dimensions: education, public health and infrastructure:

- The education services dimension is measured by mean of years of schooling for adults aged 15 years and more.
- The health services dimension is assessed by the mortality rate under 5
- The public infrastructure dimension is assessed by the km of paved road per 100 sqm<sup>13</sup>.

The PGP index is the geometric mean of normalized indices for each of the three dimensions. Thus 100 is the highest level of State's effectiveness within our sample, 0 is the lowest. We use a geometric mean because of the systemic nature of the State's capacity.

The three separate index and the summary index are calculated as follows for country i:

$$PGP_i \text{ index} = 100 \times [PGP_i \text{ value} - \text{Min PGP value}] / [\text{Max PGP value} - \text{Min PGP value}]$$

To measure social cohesion in a comparative perspective, we build a synthetic index which combines three critical aspects of social cohesion: Income inequality; Societal violence; interpersonal trust:

- The income inequality value is based on the Palma index (ie : D1/Q4+Q5) for the 1990s decade;

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<sup>12</sup> For an illustration of the divergence between "expert-based" country assessment and the reality in the case of corruption, see Razafindrakoto and Roubaud (2010).

<sup>13</sup> Education levels come from the Barro and Lee database ; Road density and mortality rates come from the WDI database. We use data in the middle of our 1980-2010 study period, when it was relevant and possible. Thus the education and road density are the 2000 values (implicitly : the cumulated outcome of the 1990-2000 decade); infant mortality value is the average between 1990 and 1999.

- Societal violence level is based on the intentional homicides rate (per 100,000 people), provided by the World Bank WDI (average during the 1990s decade or closest period available).
- Interpersonal trust relies on the percentage of positive answer to the question “*Most people can be trusted*” in the World Values Survey network<sup>14</sup> (1990s decade or closest period available).

In a similar way, indices are calculated for each variables, from 0 to 100, then these three indices are combined into a social cohesion index using arithmetic mean, because of the cumulative nature of the concept.

Table 2: Comparative indicators (from 0 to 100)

| Country / Region         | State Effectiveness Index (SE) | Social Cohesion Index (SC) | SE&SC index |
|--------------------------|--------------------------------|----------------------------|-------------|
| <b>MENA-Central Asia</b> | <b>28</b>                      | <b>65</b>                  | <b>46</b>   |
| <b>Sub-Sahara Africa</b> | <b>13</b>                      | <b>44</b>                  | <b>24</b>   |
| <b>South-Asia</b>        | <b>48</b>                      | <b>75</b>                  | <b>65</b>   |
| <b>East Asia</b>         | <b>61</b>                      | <b>93</b>                  | <b>85</b>   |
| <b>South-East Asia</b>   | <b>43</b>                      | <b>69</b>                  | <b>58</b>   |
| Singapore                | 96                             | 64                         | 92          |
| Thailand                 | 54                             | 76                         | 70          |
| Malaysia                 | 49                             | 49                         | 50          |
| Indonesia                | 33                             | 0                          | 70          |
| Philippines              | 43                             | 42                         | 43          |
| Vietnam                  | 41                             | 86                         | 67          |
| Lao PDR                  | 13                             | 84                         | 47          |
| Cambodia                 | 13                             | 51                         | 27          |
| <b>Latin America</b>     | <b>24</b>                      | <b>35</b>                  | <b>25</b>   |
| Argentina                | 26                             | 66                         | 45          |
| Bolivia                  | 12                             | 40                         | 20          |
| Brazil                   | 17                             | 0                          | 0           |
| Chile                    | 25                             | 47                         | 33          |
| Costa Rica               | 47                             | 58                         | 55          |
| Ecuador                  | 26                             | 21                         | 19          |
| Nicaragua                | 18                             | 36                         | 22          |
| Paraguay                 | 16                             | 13                         | 07          |
| Peru                     | 17                             | 36                         | 21          |
| Uruguay                  | 30                             | 36                         | 30          |
| Venezuela                | 27                             | 31                         | 25          |

Source : Author's calculation based on a 57 Developing Countries sample

<sup>14</sup> <http://www.worldvaluessurvey.org/WVSONline.jsp> (accessed November 2014)

Table 2 indicates the value for each regions and for a number of countries. State effectiveness varies within the Developing world : very weak in SSA (13% of the best performer level, Sri Lanka), better in MENA-Central Asia and Latin-America but still low, and quite stronger in Asia, especially in East Asia. While SEA relative performance at the aggregate level is “intermediate”, there are wide differences of effectiveness between the strong Singapourean State and Laos or Cambodia. On average, the level of the five SEA most populated countries is two times higher than Latin-America’s. Social cohesion differences between these two regions are similar. Finally, both dimensions are combine in the last column, using arithmetic mean (SE&SC index). To sum-up, if Cambodia is excluded, SEA performances are lower than in East Asia but superior to other developing regions levels.

### **2.3 States and social cohesion in Sout East Asia**

With the exception of Philippines and Singapore, State’s organisations - Siam, Khmer and Burma Kingdoms, Madjapahit in the Indonesian archipelago,...- existed in SEA long before the European colonization (Osborne 2010). The colonial regimes accelerated the international integration of these economies but left behind meager State’s capacities and insufficient, sometimes miserable, public goods facilities. The shortage was particularly obvious in the education sector. In 1950, average years of schooling was about 1,1 in Indonesia, Laos and Burma, 2,1 in Malaysia, Thailand and Philipinnes (but 4,5 in Korea), according to the Barro-Lee database. Thus most SEA newly independent States gave a priority to education. In Indonesia, Malaysia and Thailand, universal primary education became a major government concern and was achieved by the early 1980s. But progress in post-primary enrollments was slower and more erratic (Booth, 2003; Jetin, 2010). However, “Human capital” expanded in the region. Average years of schooling has reached about 8 years in 2010 in Vietnam, Thailand, Indonesia, Malaysia, Philipinnes and 11 in Singapore. Thus, SEA has benefited from high investments in education but educational attainment has been lower than in Northeast Asia (Japan, South Korea, and Taiwan), while inequality in access to education has been higher, Singapore excepted (Phan

and Coxhead, 2014). However, the most populated countries, including Indonesia, have improved education more efficiently than most of the DC. A large comparative study on educational achievements indicates for instance that the rich/poor ratio in PISA secondary test scores is close to 1 in Korea and Thailand, but is above 1,3 in Argentina and about 1,5 in Brazil (Di Gropello 2006). Within the region, Cambodia, Laos and Myanmar records are weaker.

Disparities in education reflect differences in State's overall capacities, both within the region and between SEA and other DC. The main advantages of East Asian "authoritarian" States were the political stability, the State autonomy and the quality of the bureaucratic elites (Johnson, 1987). The long-lasting Suharto regime in Indonesia or the Mahatir administrations in Malaysia had a long practice of concentrating all powers and they could rely on authoritarian means. It was also the case of the technocratic (and often military-supported) governments in Thailand, as well as in Myanmar or Vietnam. However, in SEA this political stability did not always lead to State autonomy and the quality of the economic bureaucracy has been variable. In Thailand, Indonesia and Malaysia, as well as in Vietnam, governments have remained autonomous for macroeconomic policymaking. They have been capable of effective policy design and implementation has relied on powerful institutions. The Bank of Thailand was early given a great degree of autonomy in deciding the monetary policy (Jansen 2001). In the 1980s, economic administrative monitoring capacity was completed with three more organizations headed by technocrats directly appointed by the Prime Minister (Amsden, 2008; Hicken, 2004). The Malaysian MITI and MIDA have also enjoyed a large degree of autonomy over several decades and were crucial in maintaining a stable development strategy (Yusuf, 2008). The intervention of a coherent and powerful group of bureaucrats, not "*seriously compromised by vested interests*", explain the success of the 1980s macro-economic reforms in Indonesia according to Hill (2014). While it may be exaggerated to classify SEA countries, except Singapore, as "strong" developmental States, it would be incorrect to assume that SEA governments did not intervene to stimulate industrial change and growth. On average, interventions were frequent and often powerful. However industrial policies were less coherent and effective than in East Asia. Studwell (2013) has precisely documented these policy failures in Malaysia and Philippines. To sum-up, most of SEA governments have been capable

of reasonably effective policymaking and their administrations have not been badly corrupt. Their institutions have been above average by developing country standards, except in Myanmar, Philippines Laos and Cambodia, as it is reflected by our SE index (table 2).

Discussion of such a diffuse phenomena as social cohesion are always perilous and can not be developed in depth here. Primary data shows that social trust is stronger in SEA than in other DC, except in Philippines, Malaysia and Cambodia, where it is very low, and that assassinations are less frequent than in the average DC, except in Thailand and Philippines. Although international comparisons of inequality indicators is difficult, the available data on the distribution of income show a less distorted distribution in SEA than in Latin-America and Africa, but higher inequality than in East and South Asia. Among the causes of these disparities, there are the initial conditions and the geo-political environment. The particular historical context under which Taiwan and South Korea began their process of development created an unusually flat distribution of income and wealth, due to the large-scale migrations from the late 1940s and the land reforms initiated by the American authorities, which had a strong redistributive impact. In SEA, a critical part of the colonial legacy was the large income disparities. Malaysia inherited a 'Latin American' pattern of inequality, with a profitable plantation economy connected to the global economy and a poor, mostly Malay, rural sector. Land reforms aborted in Philippines, where landlords kept the economic and political powers (Studwell 2013). The relative concentration of land ownership in SEA explain most of the initial inequality of income. Thailand never had a land reform, but more than 80% of land was owner-occupied (Jansen, 2001).

In the discussion of social stability and cohesion in Asia, the ethnic diversity versus homogeneity issue has often remained central. Explanation of income distribution in Taiwan and Korea has insisted on the high degree of ethnic homogeneity in both societies. Whereas in Malaysia, a long-time favourite of scholars of ethnic diversity, the sharp initial disparities in the distribution of income across ethnic groups had to be reduced by affirmative policies to avoid greater political instability and social tensions. However, causal claims and significance of the ethnic diversity paradigm have been excessive. The Government, controlled by the poorest

ethnic group, promoted a realistically inclusive approach to growth that curb ethnic and social grievances (box 1). Thus, the entire population has benefitted from the growth to some degree. In Malaysia a socio-economic perspective has started to replace the ethnic view (Yusuf and Bhattasali, 2008). Severe political or economic crises in Thailand, Indonesia and Malaysia have not led to a rise in ethnic tensions. Thus, despite the boom in studies of ethnic tensions (Gilley 2004), the empirical facts in SEA do not suggest that ethnic diversity indicators have a strong explaining power of social cohesion.

**Box 1 : Management of a multiethnic society in Malaysia**

Ethnic divisions in Malaysia have their roots in the colonial period, when large numbers of Chinese and Indian immigrated to take jobs and business opportunities. The 1957 constitution enshrined organisational principles, achieved through extensive negotiation among the major groups. However, on May 13<sup>th</sup> 1969, inter-ethnic clashes caused the death of more than 100 people and the most traumatic post-independence incident. In 1971, however, the new parliament passed a constitutional amendment that firmly established Malay primacy. The amendment made it illegal to question publicly the sovereignty of the Malay rulers, the special position of Malays or the citizenship rights of the immigrants. This ruling changed the character of electoral campaigns, since parties could no longer gain votes by relying on ethnic antagonisms.

A second initiative, the New Economic Program (1970-90) boosted the economic position of the Malays. The program had two main elements. The first was the promotion of full productive employment of Malays and an expansion of the supply of skilled Malay labor. Preferential University admissions standards for Malays almost tripled their enrollment to ¾ of the total. The second was the gradual redistribution of assets ownership. The government made it clear that it would not confiscate Chinese economic wealth, but that it would promote Malay participation in the economy. Strong growth allowed non-Malays to continue to gain while the NEP had a strong redistributive effect and ensured that the growth was shared.

**2.4 Economic resilience capability at works : a preliminary assessment**

In this section, the relationship between economic resilience and social cohesion (SC) and State effectiveness (SE) is examined more systematically. Many factors play a role in economic resilience and long term growth. Multiple regression analysis would be nicer than simple correlations, but is not feasible here given the relatively small number of sample countries and the fairly large number of possible determinants. Thus, given the nature of statistical relationships, what follows should

be interpreted as highlighting associations rather than causation, proposing stylized facts that emerge from the data.

To answer the question of how far SC and SE can explain economic resilience, first we run simple OLS regressions of our SC and SE index on the “growth losses” component of the growth gap (cf table 1), which is a proxy for the lack of economic resilience. Figure 3 shows the relationship between the combined indicator SC&SE and the share of growth losses in the total growth gap. The coefficient has the sign to be expected, it is statistically significant and our synthetic indicator “explain” here some 37 % of economic resilience variation. In figure 4a, we use the average number of points of g loss per year as an indicator of resilience. Once again, the model provides an appropriate outcome, with a very similar  $R^2$ . As expected, the relationship is much stronger between SC&SE and the resilience component of the growth gap (g loss) than with the “speed difference” component. When the economy is in expansion, figure 4b shows a very weak association between a lower growth rate and the SC&SE variables. Given this, it is worth noting that overall results hold up even when East and South-East Asia are excluded from the sample.

**Figure 3 : g loss (%) and SE & SC**

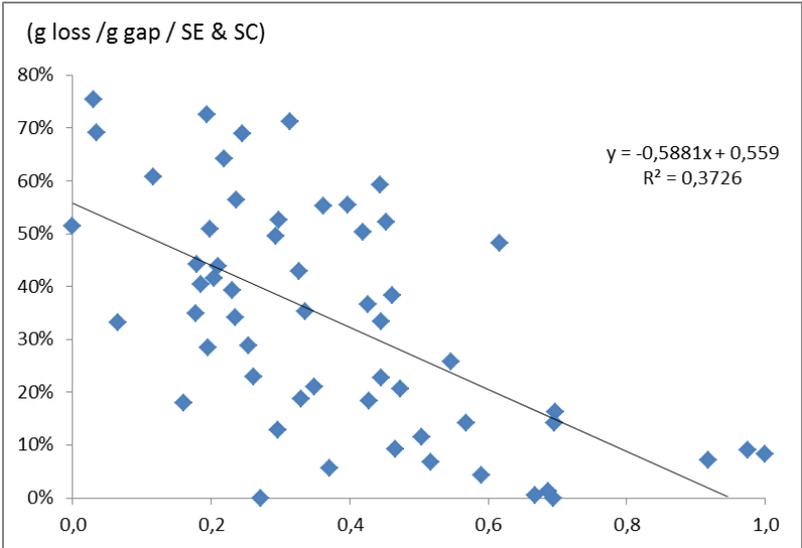


Figure 4a, 4b : g loss & g speed (points) and SE & SC

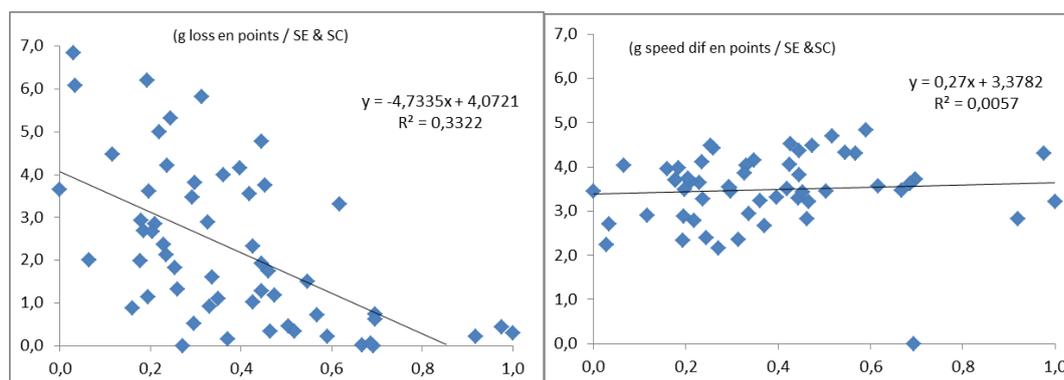


Table 3 shows the result of repeating the exercise with our different indicators, first for gloss/ggap, then for growth losses in number of points (lines 1, 2). All correlation coefficients have the sign to be expected and the statistical significance is strong. In addition, we perform correlations with an alternative index of resilience and long term growth stability : average growth rate / standard deviation, first for GDP/capita, then for GDP<sup>15</sup> (lines 3,4). For a given average expansion rate during the period, the ratio is lower if growth has been more erratic. For instance, Paraguay and Tunisia grew at the same rate, about 4 %, between 1980 and 2013. However, growth has been more stable in Tunisia (stdev : 2,4), with only two years in recession (including 2011 : -0,2 %), than in Paraguay where growth has been negative during 7 years (stdev : 4,3). Thus, for a given growth trend, the stronger the resilience capacity, the lower the measure of the instability of growth and the higher the ratio. Change in resilience indicators does not weaken the economic and statistical significance; our SE&SC index “explains” 40 % in the first case (line 3). Finally, in the last column, we add the “Government effectiveness” index<sup>16</sup>, taken from the World Bank WGI database, which is supposed to capture “*the quality of public services, the quality of the civil service (...) and the quality of policy formulation and implementation*” from a very large number of sources<sup>17</sup>, and we compare the results with our State effectiveness index, SE. The correlation coefficients of the World Bank

<sup>15</sup> Same period : 1980-2013.

<sup>16</sup> Average value on the 1996—2000 period

<sup>17</sup> See : <http://info.worldbank.org/governance/wgi/pdf/ge.pdf>

index are considerably below the correlation coefficient shown for SE and they have much weaker statistical significance.

Table 3: Correlation Results

| Resilience indicator         | SC&SE                       | SC                           | SE                           | WGI gov. index          |
|------------------------------|-----------------------------|------------------------------|------------------------------|-------------------------|
| g loss / g gap               | -0,59***<br>(-5,71)<br>0,37 | -0,49***<br>(-4,46)<br>0,27  | -0,49***<br>(-4,00)<br>0,23  |                         |
| g loss (pts)                 | -4,73***<br>(-5,23)<br>0,33 | - 3,98***<br>(-4,19)<br>0,24 | - 3,89***<br>(-3,67)<br>0,20 |                         |
| <u>g GDP/capita</u><br>stdev | 2,03***<br>(6,06)<br>0,40   | 1,65***<br>(4,53)<br>0,27    | 1,73***<br>(4,33)<br>0,25    | 0,31*<br>(2,14)<br>0,08 |
| g GDP / stdev                | 2,00***<br>(4,54)<br>0,27   | 1,77***<br>(3,95)<br>0,22    | 1,55***<br>(3,02)<br>0,14    | 0,30<br>(1,67)<br>0,05  |
| g GDP                        |                             |                              | 3,59**<br>(3,46)<br>0,18     | 0,82*<br>(2,22)<br>0,09 |

Note: t statistics in parentheses; \* indicates  $p < 0.05$ , \*\*  $p < 0.01$  and \*\*\*  $p < 0.001$

The overall picture that emerges is one in which State effectiveness, when reasonably appreciated, and Social Cohesion explain a large part of economic resilience difference between countries. History of crisis episodes in South East-Asia illustrate these relationships. In his reference study of crisis in Asia and Latin-America, Maddison (1985) insisted already on the role of government effectiveness. He proposed a second reason to explain the speed and the quality of adjustment policies in Asia, there had been less manifest distributional conflicts. More recently, in the countries most affected by the 1997-1998 Asian financial crisis, government's effective capacity to implement rapidly adjustment measures were critical in containing the negative economic impact of the initial shock. The reform process interacts with social cohesion, notably because a sufficient degree of social cohesion is a condition of credibility for governments engaged in negotiation with foreign creditors and institutions. Preservation of the policy tools to strenghten the political stability and social cohesion was a key factor in determining the unorthodox response

of Malaysia - capital controls - to the crisis in 1998<sup>18</sup>. In Thailand, and in South-Korea, social stability and democratic institutions played an important role in adjustment policies to the crisis (Rodrik, 1999). Democracy provides mechanism of “voice” that facilitate a soft transfer of power to newcomers<sup>19</sup>. Indonesia, where recovery was slower offers an interesting counter-example in the region, that can be associated to a weak State effectiveness (see SE index in table 2). The economic crisis interacted with the decline of the Soeharto’s regime and the fall of the government capabilities. Each crisis - the economic and the institutions collapses - was made worse by the other (Corden, 2007). Some members of the governing party blamed the Chinese business community and incited to ethnic tensions (Rodrik, 1999). The Chinese businessmen lost confidence in their security, and that added to the flight of capital. Obviously, social cohesion was not strong enough to compensate for the sudden dilution of the State’s authority. Since then, major institutional changes have been implemented in Indonesia and the country was much less affected than Thailand, Malaysia, Singapore and Philippines by the 2009 world crisis.

## **Conclusion**

The main results here are that (a) increasing economic resilience – ie : reducing the loss of growth during recessions - is critical to achieving high growth rate over the long term; and (b) countries with more social cohesion and better State effectiveness tend to have significantly stronger economic resilience. Further research will be conducted to evaluate more precisely the impact of these variables on long term resilience and growth, and how they interact with other policy and structural factors.

The evidence presented have already clear implications for international institutions involved in the design of adjustment plans, such as the Washington institutions or the EC. In a policy perspective at the country level, our results

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<sup>18</sup> The IMF program was not politically acceptable to the Malaysian government, as it was summed up by Prime Minister Mahathir: “[I]f we have to resort to the International Monetary Fund assistance ..., the conditions imposed by the IMF will require us to open up our economy to foreigners. There will not be any Bumiputera quota as the New Policy is an injustice, and unacceptable to their liberal democracy”. Quoted in Athukorala (2010).

<sup>19</sup> Since then, the widening gap between rural and urban households has eroded the social cohesion in Thailand and produced dangerous unresolved political tensions.

suggests that social cohesion and State's capabilities must be consolidated and promoted to benefit from the gains of economic openness. It is a necessary condition of any international integration strategy.

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