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Small-Scale Mobility and Unskilled Labor in Southeast Asia

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CHAPTER 7

An Uneven Development Trap in Southeast Asia and Its Implications for Labor

Pietro P. Masina

In the early 1990s Southeast Asia was considered to be on track for repeating the so-called East Asian miracle. After the regional crisis of 1997–98, however, it became clear that the miracle was either a mirage or a smokescreen used by the international financial institutions to push the Southeast Asian countries towards further neoliberal reforms. By the early 2010s the World Bank had repackaged its discourse, indicating that a number of Southeast Asian countries—Malaysia, Thailand, Indonesia, and Vietnam—were facing a "middle-income trap" because they had not done enough in implementing the prescribed liberalizations.

This chapter will try to present an alternative view. The current "trap" can be better understood as a result of uneven development strategies, based on those neoliberal principles that the World Bank would like to see even more thoroughly implemented. High dependence on foreign direct investment (FDI) and a captive position in foreign-led commodity chains have strongly reduced the possibility of moving out from labor-intensive and low-value-adding production. Industrial employment has grown rapidly in these prospective "fifth tigers," but wages have remained low and working conditions unattractive. The high competition in the region has produced a "race to the bottom" instead of a convergence towards better wages that is imagined by conventional (neoclassical) wisdom. The uneven development that characterizes the industrialization process in Southeast Asia makes it clearly unfriendly to labor, and the reforms proposed by the World Bank are expected to make labor even weaker and more vulnerable.

The Middle-Income Trap, the World Bank, and the Art of Paradigm Maintenance[1]

The notion that East Asia could fall into a "middle income trap" was first introduced by the World Bank in 2007 by Gill and Kharas. The construction of this influential discourse should be understood as part of an attempt to regain intellectual leadership in development studies. Since the publication of the *East Asian Miracle* (World Bank 1993), the Bank had not been able to create a consensus around a strong and credible interpretation of economic development in the region characterized by the fastest growth rates. The *East Asian Miracle* itself had already been an attempt to respond to the powerful critiques of neoclassical interpretations of economic development in the region. Authors such as Alice Amsden and Robert Wade (often referred to as statist scholars) had convincingly argued that the developmental policies of East Asian governments had played a key role in helping them catch up with industrialized countries (Amsden 1989; Wade 1990). The *East Asian Miracle* tried to confute that argument in two ways. On the one hand, it acknowledged the importance of government policies but opposed the focus on selective industrial policies as the key engine of growth, suggesting that "sound" macroeconomic policies accompanied by investments in health and education had been the real causes of economic success. On the other hand, it constructed market-friendly (that is, open to FDI and free trade) Southeast Asian countries—specifically, Indonesia, Malaysia, and Thailand—as better models for sustainable economic development than the market-distorting countries of Japan, South Korea, and Taiwan (Jomo 2005; Masina 2014).

In many regards, the 1993 World Bank report anticipated the post–Washington Consensus promoted in the late 1990s by Joseph Stiglitz, one of the key authors of the *East Asian Miracle* and at the time the World Bank's chief economist and senior vice president. The East Asian economic crisis of 1997–98—and the failure of the international financial institutions to foresee and address it adequately—compelled the departure from the theories and practices supported until then by the Washington Consensus. The new consensus rejects the rigid assumption that self-regulated markets

are always able to reach optimal equilibriums. It promotes governance instead of deregulation, safety nets to reduce the social costs of pro-market economic reforms, moderate investment in health and education, and national ownership of (rather than externally imposed) economic reforms. However, the new consensus does not imply a substantial departure from previous policies as it continues to promote trade liberalization, export-led industrialization based on FDI attraction, and, more generally, sound macroeconomic policies with a de facto regressive impact in terms of income polarization and inequality (Masina 2006).

The new post–Washington Consensus inspired by Stiglitz is reflected in a number of World Bank studies on East Asia. These studies revalue the role of institutions and legitimize state interventions in addressing market failures—that is, those cases in which the market is not able to function at optimal levels (see, in particular, Stiglitz and Yusuf 2001). In this framework, there is an attempt to provide an interpretation that addresses East Asian dynamics, which have produced irreconcilable contradictions for mainstream neoclassical economic theory.

The first contradiction is the rise of China. Although interpretations diverge in assessing the role and the impact of state policies, no one can reasonably argue that the impressive economic growth achieved by this Asian giant has been (simply) the result of market forces. There is substantial evidence to argue that the transformation of China into the world's largest manufacturing center has been the result of national and provincial industrial policies, which provided incentives, created and allocated rents, and directed market forces to well-designed objectives (see, for example, Di Tommaso, Rubini, and Barbieri 2013).

The second major contradiction is connected with the previous World Bank discourse about economic development in Southeast Asia. If the regional economic crisis of 1997–98 had been a significant crack in the miracle theory supported by the Bank, the subsequent slow-growth recovery was the final blow. Critiques of the *East Asian Miracle* had already suggested that when the World Bank report was published growth patterns in (some) Southeast Asian countries were notable by international standards but

were much slower than those experienced by the first generation of the Asian Newly Industrializing Economies (NIEs: Japan, and later South Korea, Taiwan, and Singapore) at the same levels of economic development (Masina 2014). Figure 7.1 shows quite clearly the difference in growth trends between the first generation of Asian NIEs and the "second tier" represented by Malaysia, Thailand, and Indonesia, which I refer to as the ASEAN 3. Figure 7.2 allows us to assess East Asian catching up with "core" economies (here represented as a proxy by the US GNI per capita at parity of purchasing power). Even the most successful among the ASEAN 3—Malaysia—did poorly compared to South Korea: in 1980 both countries had a GNI per capita that was about 20 percent of that of the US; in 2008 South Korea had reached 60 percent, while Malaysia was still at about 30 percent. The apparent success in catching up in the period immediately after 2008 should be understood as a result of the global crisis and a weakness of "core" economies (including the US) rather than the strength of the ASEAN 3.

At the end of the first decade of the new millennium, the World Bank and mainstream economists had to come to terms with the fact that the three countries identified as models of economic success—Indonesia, Malaysia, and Thailand—had clearly proved unable to significantly reduce the gap with industrialized economies in terms of GDP per capita. In Thailand and to a large extent in Malaysia this failure to live up to (unrealistic) expectations of economic growth also contributed to severe political crises. The contradiction for the World Bank was that since the late 1980s the ASEAN 3 had followed neoliberal economic policies—relying on FDI-led industrialization processes[2] and trade liberalization—and for this reason they had long been considered models to be promoted internationally. The developmental impasse in the ASEAN 3 represented a major challenge to World Bank legitimacy as a policy advisor and required a response. This response was constructed by creating the notion of the middle-income trap, which suggested that the ASEAN 3 had failed to adequately implement the prescribed reforms (and were therefore responsible for their quandaries) and that the solution lay in bolder neoliberal policies.

The first World Bank–inspired study to introduce the middle-income trap was the one already mentioned by Gill and Karas in 2007. This study was still positive and encouraging, as its title suggests—*An East Asian Renaissance*. The "trap" notion was used to indicate a way out to those countries able and willing to implement the right policies:

> Middle-income countries . . . are squeezed between the low-wage poor-country competitors that dominate in mature industries and the rich-country innovators that dominate in industries undergoing rapid technological change. This is the challenge that confronts East Asian countries today, especially those in Southeast Asia. There is reason for optimism. The newly industrializing economies in East Asia successfully made this transition from middle income to rich, showing that such a transition is possible under the proper circumstances and the correct policies. (Gill and Kharas 2007, 5)

The "correct" economic policies proposed by this report are those that promote a greater integration in the world economy, allow a stronger specialization in industrial production, and develop an economy of scale. In this context, FDI flows are seen as a facilitator of intra-industry trade and instrumental for the diffusion of new knowledge (Gill and Kharas 2007, 75). Although the study underlines the risks connected with the rapid process of economic and social transformations in East Asia—a hasty and disorderly movement of people from the countryside to urban areas, growing inequality in a context of absolute poverty decline, strong and increasing corruption—the prognosis remains optimistic.

Only a few years later, however, the question of the middle-income trap broke into the policy debate in Southeast Asia in more critical terms. Already in 2009 a new World Bank study referred to the middle-income trap, expressing the fear that Southeast Asia may not only fail to repeat the miracle of the first generation of Asian NIEs, but may face a dangerous decline:

> The Southeast Asian Tigers feel threatened. Even though their growth rates have remained above the average for the world and also above the average for developing countries, their economic performance falls short of that in the first half of the 1990s. The underlying worry is that it presages the beginning of a downward trend, the harbingers of which are lower rates of investment, persistently low rates of total factor productivity, and low levels of innovativeness. (Yusuf and Nabeshima 2009, 3)

At the same time, a wider international debate on the nature and characteristics of the trap emerged. New research tried to understand whether the trap was the result of specific conditions in selected countries or whether it was possible to discover determinants that explain the challenges to be addressed in order to graduate to a high-income country. This line of investigation reflects the neoclassical view for which there is a tendency towards a convergence in cost of production factors among countries at different stages of economic development, and therefore a tendency towards a convergence in income levels.

A study published by the National Bureau of Economic Research of the United States suggests that countries whose per capita income gets close to 16,700 dollars face a slowdown. At this stage the yearly GDP per capita growth declines from 5.6 to 2.1 percent (Eichengreen, Park, and Shin 2011, 5). The explanation of this slowdown is based on already known principles, which were at the basis of a famous article published by Paul Krugman in 1994, "The Myth of Asia's Miracle." During early stages of economic development a country can rely on abundant and cheap labor, and any introduction of new technologies results in a huge increase in productivity. These advantages, however, decline once higher levels of industrial development have been reached. The transfer of people from scarcely productive occupations in agriculture to industry allows a country to increase its overall productivity through the export of labor-intensive and cheap goods. Once the middle-income level has been reached, the reserve pool of unproductive rural workers shrinks and salaries tend to increase, making the country less competitive in

labor-intensive productions compared to countries with cheaper labor costs (Eichengreen, Park, and Shin 2011).

Along these lines, a World Bank study suggests that the decline in productivity leading to the middle-income trap is the result of a limited ability to move to more knowledge-intensive productions due to structural bottlenecks:

> We emphasize interactions between three determinants of productivity growth: individual decisions to acquire skills, access to different types of public infrastructure, and knowledge network externalities—which we define as the possibility that a higher share of workers with advanced levels of education has a positive impact on their performance, that is, their ability to take advantage of existing knowledge. (Agénor and Canuto 2012, 4–5)

From this analysis the authors of the study derive policy proposals that are coherent with those typical of the World Bank at the time:

> There are a number of public policies that developing countries can employ to avoid or escape from middle-income growth traps. Such measures include developing advanced infrastructure in the form of high-speed communications networks, improving the enforcement of property rights through patent protections, and reforming labor markets to ensure that rigidities do not prevent the efficient firing and hiring of employees. Fundamentally, these policies attract more high-ability workers into the design sector, improve productivity and wages in that sector, and increase a country's capacity for innovation. (Agénor and Canuto 2012, 7)

In presenting policies needed to escape the trap, the World Bank implicitly suggests that responsibility for the economic impasse lies primarily with the countries themselves: it was the lack of adequate reforms—such as a further liberalization of the labor market—that did not allow them to improve

productivity and therefore reach higher income levels. The World Bank suggests increasing the level of specialization within regional production networks, but its analysis conceals a crucial feature of these networks: their hierarchical nature, in which companies (and countries) actively work to prevent technology diffusion towards companies (and countries) operating at lower echelons in the regional division of labor. To promote industrial upgrading the World Bank continues to rely on the mainstream notion that foreign direct investment is a major channel of technology transfer towards developing countries. However, this notion does not take into account the empirical evidence and the substantial literature that demonstrate the very limited impact of FDI in technology transfer towards developing countries. For instance, Alice Amsden already at the turn of the century argued convincingly that technology diffusion occurs more frequently among national companies than among foreign subcontractors within production networks (Amsden 2001).

The discourse promoted by the World Bank continues to present the regional division of labor as a neutral arena in which market forces will spontaneously distribute benefits to all the participating countries if the correct liberalization reforms are implemented. This discourse serves, on the one hand, to defend the correctness of the policies promoted by the World Bank in the past thirty years and, on the other hand, to continue to conceal the importance of state-led policies for technology absorption and industrial upgrading. In a way, the middle-income trap thesis promoted by the World Bank creates more problems than it is able to solve. Suggesting that the trap is the result of a scarce ability to innovate, absorb technology, and climb the value chain in a production network is useless unless it leads to a meaningful analysis of the constraints to be addressed and of the policies that can be used to address them. However, the World Bank, even within the relatively more open and tolerant post–Washington Consensus framework, cannot engage in this analysis because the only admissible policies are those strengthening the operation of a self-regulated market. The Bank continues to oppose the view that countries at lower levels of economic development need state-coordinated policies to overcome their limited ability to absorb technology,

invest adequately in innovation, and shelter infant industries from excessive competition from more industrially developed countries.

Neo-institutionalists, on the contrary, present interesting analyses to assess the reasons for which the ASEAN 3 have failed to further upgrade their industrial capacity after the first successful stages of FDI-led industrialization. In developing countries the market alone cannot guarantee levels of investment adequate for industrial innovation because these investments are too risky for a single company. A rapid and sustained improvement in productivity, therefore, requires state intervention, through incentives and constraints, to encourage and support technological progress.

> Building up technological capacity can yield very high returns in the future but because the "risk" of failure is uninsurable, private investors are unlikely to play a big role in making investments in learning at early stages of development. Rapid catching up therefore requires strong industrial policy, described as some strategy of targeted technology acquisition that allows the follower country to catch up rapidly with leader countries. While technical progress is possible along the trajectory set by a market-driven strategy, the climb up the technology ladder is likely to be much slower than with an active technology acquisition and learning strategy. (Khan and Blankenburg 2009, 336)

Mainstream economists oppose active state-led industrial policies on two grounds. First, meaningful industrial policies are *per se* selective and distorting, as incentives and constraints are used to promote certain sectors (and in some cases, even single enterprises) while sacrificing the interests of non-strategic sectors and firms (Chang 2003, 112). Mainstream economists believe that the risks of policy failures are always bigger than the risks of market failures. Thus, they advocate for much weaker state intervention in industry, typically implementing anti-trust policies to enable competitive markets. However, the historical experience of the first generation of Asian NIEs indicates that active and selective industrial policies have largely

Fig. 7.1. GDP per capita for selected Asian countries, 1960–2008

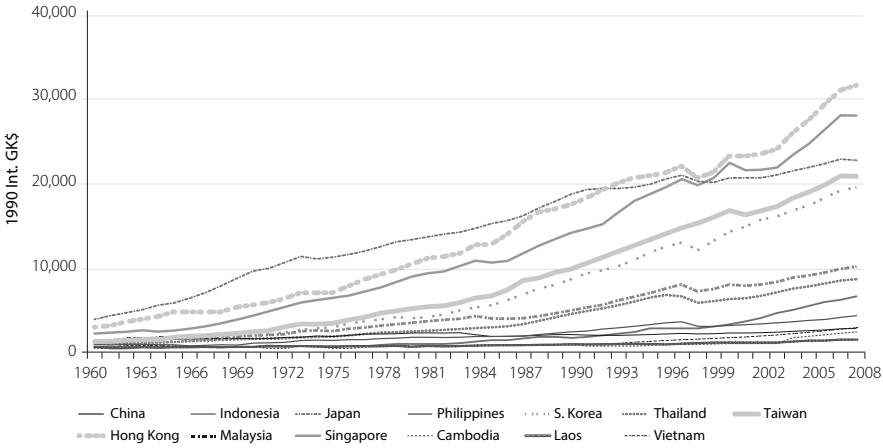
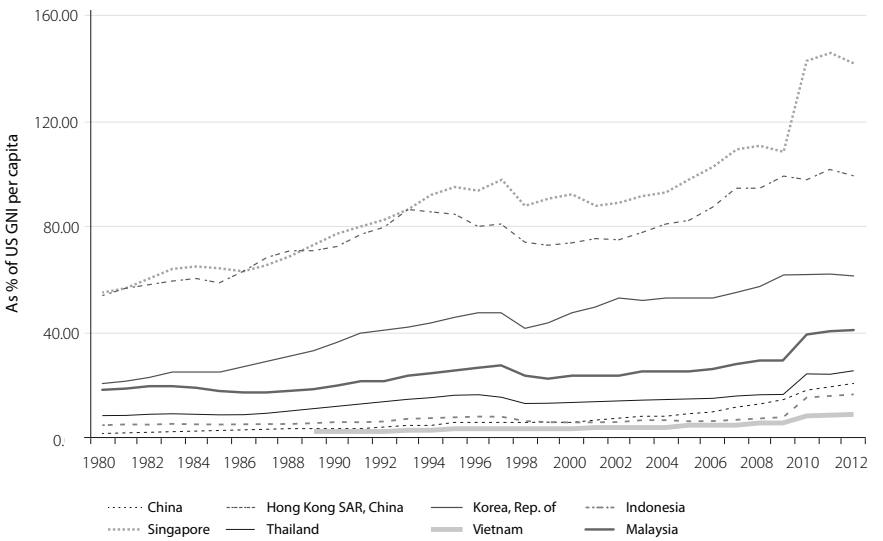


Fig. 7.2. GNI per capita (PPP) growth for selected Asian countries, 1980–2012



contributed to the successful upgrading of technology, shaping the only economic process that can legitimately be labeled an "East Asian Miracle" (Masina 2014).

The second argument normally used by mainstream economists is that market-distorting industrial strategies are too risky and complex to be promoted in developing countries. Japan, South Korea, Taiwan, and Singapore may have benefited from these policies due to exceptional (and therefore not repeatable) conditions and especially due to a particularly skilled bureaucracy. Fittingly, Ha Joon Chang responds to this argument by saying that macroeconomic policies are no less risky and complex, but no one would suggest that governments—even the weakest ones—should not implement them (H. Chang 2006, 241). The challenge for governments in designing and implementing strategic industrial policies is not so much technical as political. Selective industrial strategies require the ability to discriminate among different interests and stakeholders, allocating incentives and creating rents in favor of those interests—either industrial sectors or individual firms—that are considered to be key for accelerating the national technology and industrial development. The political weakness of the ASEAN 3 prevented government institutions from implementing strategies in the wider interests of their respective countries. State apparatuses were often captured by the particularistic interests of powerful stakeholders and thereby allowed rent-seeking behaviors to influence national policies. In other terms, the different political conditions and constraints determined how the different countries responded to the challenges and opportunities created by regional economic integration. While the first generation of Asian NIEs was able to play a proactive role through developmental state policies, the ASEAN 3 remained more passive (that is, letting dominant market forces shape industrial development) or intervened to protect the rent-seeking interests of powerful stakeholders. The question of how to manage state interventions to facilitate industrial upgrading remains highly relevant in addressing the developmental impasse of the ASEAN 3. Contrary to the view proposed by the World Bank, a successful answer to the so-called middle-income trap cannot depend on generic pro-market reforms but rather on selective

industrial strategies. As suggested by Khan and Blankenburg, the state should take into account the prevailing economic and political equilibriums and promote policies that, through incentives and constraints, maximize the positive impact of rents on the national objectives guaranteed to specific sectors (and firms).

> When states intervene in markets to assist technology acquisition, by definition, they create new incentives and opportunities, and the market on its own may well not suffice as a disciplining mechanism for the resources allocated by the state . . . the diversity of the Asian experience tells us the importance of the compatibility of the institutional compulsions that industrial policy strategies require to be successful with the organization and structure of political power in that society that may or may not allow the effective enforcement of the requisite strategy. (Khan and Blankenburg 2009, 337)

As we have seen, the World Bank's attempt to explain the ASEAN 3 impasse in terms of the middle-income trap and to derive from this interpretation a set of policy proposals has not been able to generate a new consensus. Alternative views seem to be more able to explain why the ASEAN 3 failed to repeat the impressive catching up of the first generation of Asian NIEs. Other Southeast Asian countries—notably Vietnam, which is currently portrayed as a regional champion—may soon face a similar developmental impasse. It can be reasonably argued that the very notion of the middle-income trap could have been designed as a kind of smokescreen to hide the fact that many of the problems faced by the ASEAN 3 derive from their dependent industrialization following a model suggested and promoted by the World Bank and mainstream economists. In the following pages we will explore how this dependent industrialization has not only generated an economic deadlock but has also contributed to a path of socioeconomic development unfriendly to labor that produces vulnerability and inequality.

Dependent industrialization and uneven development in Southeast Asia

The second great expansion of the Japan-led regional division of labor in East Asia and Southeast Asia began in the late 1980s. The roots of this second expansion lie in a number of changes within the region and in its relation with the wider economy. The growing American trade deficit with Japan in 1985 motivated the Plaza Agreement, resulting in a sharp appreciation of the Japanese yen. This, in turn, badly affected the competitiveness of Japanese productions and motivated a large wave of industrial delocalization. Japan became the largest source of FDI worldwide and started to invest heavily in the United States and in the European Union to allow Japanese firms to become "local" producers within these strategic regions. At the same time, Japan substantially increased the delocalization process within East Asia. The countries that the Japanese firms had relied upon during the first expansion of the multilayered subcontracting system, that is, South Korea, Taiwan, and Singapore, by the mid-1980s were no longer suitable for labor-intensive operations as their cost of labor had increased dramatically. The concurrent democratization processes in South Korea and Taiwan in the late 1980s came at a time in which these economies had reached an industrialized status and their firms were able to climb the value chains in regional production networks sometimes in competition with Japanese firms.

The need for the Japanese firms to find suitable locations for transferring the more labor-intensive phases of production became stronger when firms from Taiwan and South Korea began facing a similar need. This pressure on the regional production networks to expand explains why, from the late 1980s, a number of new countries came to be heavily integrated in them: China, which became even more important from the early 1990s, as well as Malaysia, Thailand, and to a certain extent, Indonesia (Masina 2014). From 1985 the level of Japanese FDI in manufacturing to Southeast Asia exceeded that to South Korea, Taiwan, and Singapore, and by the end of the decade the level of foreign investment in the ASEAN countries was twice as high as that in the NIEs. While Japanese investment to South Korea and Taiwan shifted towards the service sector and production for their

internal markets, Southeast Asia became the host of larger investment flows in manufacturing—with a move from textiles to electronics—for export-oriented productions (Bernard and Ravenhill 1995, 181).

This new wave of intra-regional investment was noteworthy both in quantitative and qualitative terms. In quantitative terms it was so large as to change the shape of regional production networks.

> Japan's investment in manufacturing in other Asian countries in the years 1986–89 exceeded the cumulative total for the whole of the 1951–85 period. In 1990 the flow of investment accelerated, with $10 billion invested in manufacturing in ASEAN and $8 billion in the Asian NICs. . . . The growth in Taiwanese and Korean investment in ASEAN was even more spectacular. At the end of 1987 the total stock of Taiwanese investment in manufacturing in ASEAN stood at $78 million. In the following three years over $850 million was invested. As was true for Japanese investment, electronics was the single largest sector, with 39 percent of the total. A similar surge, although at lower levels, occurred in outflows from Korea: in 1985 the cumulative investment from Korea in ASEAN amounted to only $42 million; in 1989 alone new investment from Korea amounted to $132 million. By the end of the decade Taiwan had replaced the United States as the second most important investor in ASEAN and had overtaken Japan as the single largest investor in Malaysia. The share of the four East Asian NICs combined in foreign investment in all ASEAN countries except Thailand was comparable to or exceeded that of Japan. (Bernard and Ravenhill 1995, 181–82)

The qualitative changes were also extremely important, as they contributed to determine industrialization processes quite different from those of the countries that had been included in the regional productive system during the first expansion—especially South Korea and Taiwan. These qualitative changes were connected with the global reorganization of production and new managerial models connected with higher costs of oil and commodities

since the 1970s, capital-labor conflicts, and the advent of neoliberalism. These changes brought an internal reorganization within firms and in their relations with subcontractors that involved total quality management, lean production, and "just in time" fulfillment. The aim was to better integrate and improve the control over the entire supply chain in order to cut costs and increase productivity. As a consequence of this new strategy the transnational corporations (TNCs), including those from Japan and the NIEs, in key sectors such as electronics and automotive tended to re-internalize operations and to rely on green field, 100-percent-ownership investment operations in ASEAN countries.

During the first expansion of the regional division of labor, Japanese firms had integrated independent Korean and Taiwanese companies into their supply chain—and even when joint ventures had been established, the aim was to activate local competencies and resources in order to strengthen the Japan-led production networks. The same strategy had been applied on a smaller scale in Southeast Asian countries. However, from the mid-1980s the integration of new local firms within the production network dominated by Japan and the NIEs mostly involved subcontractors providing labor-intensive and low-value-adding components. TNCs tended to reinternalize core operations and to further strengthen the cooperation with traditional suppliers.

> As leading MNCs from the Triad had begun to exploit new technologies and organisational techniques . . . to more closely control and integrate their international operations, they began to view internalisation as a source of strategic competitive advantage. (Felker 2003, 260)

Already before the regional crisis of 1997–98 it became evident that these changes in the managerial and production strategies implied a radical transformation of the *modus operandi* of the regional production system, with negative consequences for industrial diffusion and technology transfer for Southeast Asian countries. The production networks dominated by

the Japanese firms abandoned their previous territorial logic and became much less coherent with national industrial development projects. Functions within production networks were located in different countries of the region, depending on the interest of the mother company, with scarce involvement of local firms and limited effect of extension and intensification of industrial capacity. As noted by Walden Bello already in 1992,

> many of the big Japanese enterprises migrating in the latest wave are accompanied by their small-size suppliers and contractors, resulting in the recreation in ASEAN of the same Keiretsu clusters or conglomerate alliances back home, often to the detriment of local suppliers. (Bello 1992, 91)

These transformations in the functioning of the regional division of labor have produced important consequences for the ASEAN 3 in the following years as they have made it extremely complex to pursue autonomous national industrial development projects. Contrary to a mainstream view that an FDI-led industrialization model is beneficial for developing countries as they can benefit from technology transfer, the new modalities of regional integration have become an obstacle for industrial upgrading for those countries located at the bottom of the production hierarchy (Hart-Landsberg and Burkett 1998). National firms in Thailand, Malaysia, and Indonesia gain very little in terms of knowledge and technology transfer and are barely integrated in the supply chain of industrial operations of foreign-invested companies.

> Indigenous supplier industries remained underdeveloped. Singapore was an exception in this regard, and there was limited linkage formation in Penang (Malaysia) and Thailand's car manufacturing sector. Even in these cases, few local firms progressed vigorously along the value-added chain, to full turnkey original equipment manufacturing (OEM) and then into ODM [original design manufacturing] and specialised niche manufacturing based on proprietary engineering, design, or innovation capabilities. Moreover,

> foreign makers continued to dominate production of technologically mature industry segments such as electrical appliances and white goods. (Felker 2003, 261)

The vulnerability of the ASEAN 3 to this modality of integration in the regional division of labor was by a large extent due to the weakness of industrial development prior to the large FDI flows that pushed them to specialize in export-oriented production. Both South Korea and Taiwan had gained relevant industrial and managerial experience during the harsh Japanese colonial period, which had eventually allowed them to seize the opportunities created by economic regional integration after World War II. Furthermore, the first-generation Asian NIEs had relied on an adequate phase of protection for local infant industries, selectively combining import-substitution policies with export promotion to serve national industrial development (Wade 1990; Amsden 1989). The ASEAN 3 were never able (or were never allowed) to put in place development strategies aimed at expanding and enhancing national industrial capacity. Thus, the ASEAN 3 could be considered "semi-developmental states," in the sense that while they tried to emulate the model of the first-generation Asian NIEs also through the creation of ad hoc government agencies, they never had the same ability or commitment to engage in the kind of state-led industrialization practices that had been previously experimented with by South Korea and Taiwan (Booth 2001). As rightly argued by Linda Weiss,

> what stands out is the inconsistency, weakness or absence of their developmental priorities and arrangements and thus their relatively low transformative capacities. One notable consequence has been the virtual absence of a strategic industrial policy whereby resources can be channeled more readily into the tradeables sector and productive projects with strong growth prospects. This stands in striking contrast to the highly coordinated investment and upgrading strategies put in place earlier by the Koreans, Taiwanese and Japanese at a similar stage of development. (Weiss 1995, 24)

The lack of strong national industrial strategies was the result of various factors, including the historical heritage of the colonial era that had shaped these economies to serve the needs of European countries rather than national objectives.[3] The ASEAN 3 institutional weakness—at least when compared with that of Japan and the first generation of Asian NIEs—was at the same time a result and a cause of the inability to manage rents and to prevent destructive rent-seeking behavior on the part of economic and political elites. In the absence of strong national development policies, FDI-led and export-oriented industrialization has often increased the distortions produced by rent seeking. While South Korea and Taiwan (as well as Japan) are known for high levels of corruption, corruption did not prevail over national development strategies and often became functional to them, to the point that Mushtaq Khan coined the term *growth-enhancing corruption* in reference to these countries. While the ASEAN 3 did somehow better than South Asian countries—for which Khan used the more critical term, *growth-hindering corruption*—they remained halfway between these two extremes due to a relatively scarce ability to manage and control rent seeking (Khan 2000).

> Unlike the experience of Korea and Taiwan, the recent move to manufacturing for export in Southeast Asia did not build on an experience of successful import-substituting industrialization. Rather, the new exporting industries have been grafted onto economies whose small manufacturing sectors are notable for their histories of rent seeking and inefficiency. (Bernard and Ravenhill 1995, 196)

The limited experience in the autonomous development of national industry, including import-substitution policies, have led Kunio Yoshihara to argue that the economic development in Southeast Asia could be considered as a sort of ersatz capitalism (Yoshihara 1988). This definition is confirmed by the very high level of industrial export under the control of foreign firms in the ASEAN 3 countries. The high dependence on the FDI is not only a

characteristic of the industrial development in the ASEAN 3 (contrary to the experience of first-generation Asian NIEs[4]), but it also represents the main reason for the fragility of this model—*cum bona pace* of the World Bank's middle-income trap narrative. The FDI-led industrialization in the ASEAN 3, as well as in Vietnam after the mid-2000s, is characterized by very limited backward and forward linkages with national companies. The supply chains for export-oriented production are almost entirely controlled by foreign firms and typically the most value-adding components are imported. Even the industrial sectors that have been presented as success stories—electronics in Malaysia, automotive in Thailand—are characterized by this high dependence on foreign capital, in a process that tends to consolidate over time. The same pattern has become visible in Vietnam in the garment sector and, from the 2010s, in export-oriented electronics (Masina 2014).

This ersatz industrialization pattern seems scarcely to contribute to the acquisition of technological and managerial capabilities through the inclusion of ASEAN countries in foreign-led production networks (Hart-Landsberg and Burkett 1998). These countries remain highly vulnerable to the endless process of reorganization of regional production networks, for which lead firms shift productions from country to country in a continuous effort to reduce costs. After the FDI peak in the period 1989–91, the ASEAN 3 were soon exposed to the competition of new entrants in the regional division of labor, especially China and then Vietnam. The limited rooting of foreign-invested operations in Southeast Asia makes it easy to move to other countries (as when many electronics firms delocalized from Thailand to Vietnam in the 2010s) in a process that exposed each country to stiff competition in terms of labor costs, tax rebates, and other pro-capital incentives. This condition could be defined as a dependent development trap. Not only did it result in a high level of vulnerability for the countries, which depend on foreign direct investment to maintain their position in regional industry, but also for the workers, who are exposed to a race to the bottom in terms of wages, working conditions, and rights.

Uneven development and implications for labor

Industrialization in Asia never was labor friendly. The postwar Japanese reconstruction was accompanied by the suppression of trade unions and the strengthening of authoritarian forms of control over industrial labor. Until the late 1980s, South Korea and Taiwan were ruled by dictatorial regimes that promoted industrialization but suppressed workers' rights (Deyo 1989). The East Asian high growth levels, however, also supported a generalized improvement of living conditions through a paternalistic but inclusive social model. East Asian countries never implemented universal welfare systems similar to those developed in Western Europe as part of a Fordist-Keynesian compromise between capital and labor. However, public health care and education schemes facilitated social inclusion. Wages increased in line with productivity as many enterprises moved to more technology-intensive and value-adding productions. The East Asian growth models of Japan, South Korea, and Taiwan seemed to confirm the modernization theory for which

> growth leads to the establishment of a mass consumption society where workers are integrated as the consumers necessary for the maintenance of the capitalist economy. Workers do better and work becomes less grossly exploitative. (Hewison and Kalleberg 2013, 398)

The Japanese system of life-long employment was typical for workers of leading firms, while companies at the bottom of the subcontracting system normally relied on more flexible and precarious forms of employment. To a large extent, however, industrial development was accompanied by a permanent movement of people from rural to urban areas and from agriculture to industry and the service sector. It was only with the East Asian NIEs' convergence with neoliberal policies since the late 1980s that precarious employment began to permeate industrial relations in core segments of the economy and leading firms. The firms' attempt to cut labor costs in response to heightened global competition—which in East Asia was further complicated by the Plaza Agreement—led to a strategy based on three distinct but coordinated elements: first, the delocalization of labor-intensive

production to other countries with lower labor costs; second, technical and managerial innovations (lean production); and third, a reduction of wages and workers' rights through higher levels of labor precarization. In a neoliberal context this precarization process became politically viable as the first two elements of the strategy increased the competitive pressure on labor in core economies and impaired the resistance of organized labor.

In the case of the ASEAN 3 countries (and, later on, Vietnam and the other "emerging" Southeast Asian industrial centers) the inclusion in the regional production system becomes more significant when neoliberal policies have already transformed the global economy. Precarious employment in the new foreign-invested firms, or in nationally owned subcontractors of international firms, becomes the dominant feature for two fundamental reasons. First, labor-intensive operations conducted by firms at the bottom of hierarchical production networks are particularly vulnerable to prize competition and, particularly, competition in terms of labor costs. Second, higher levels of labor flexibility and precarization are, as we have just seen, an integral part of the delocalization strategy of leading firms. Precarization and informalization of labor do not occur when industry has already developed but are constitutive features of industrial development in these countries. As correctly noted by Hewison and Kalleberg, on the basis of a wide study of several Asian economies, in Southeast Asia,

> workers are moving from the agricultural sector to the industrial and service sectors. However, these latter sectors have already been subject to processes of flexibilization and are characterized by the extensive use of precarious forms of employment. Industrialization in these countries is taking place in the context of international competition in global production chains and the enormous expansion of service sectors, both requiring flexible employment. This means that uncertain, unstable, and insecure employment practices are the "standard" and generally not a wholesale transformation of previous patterns. These practices are implemented to reduce costs and

> maximize flexibility for employers competing globally. (Hewison and Kalleberg 2013, 398)

The dependent nature of industrial development and a labor force inherently flexible and precarious set Southeast Asia apart from the historical experience of the East Asian NIEs and contradict the modernization theory of development. As we have seen already, the importance of Southeast Asia in the regional division of labor substantially increased since the mid-1980s, thanks to large FDI flows. The integration of new countries in the regional productive order continued over time: Vietnam, Cambodia, Laos, and more recently, Myanmar. Particularly relevant is the inclusion of Vietnam since the mid-2000s, which has transformed this country into an important manufacturing hub (Masina 2014). However, in structural terms little has changed in the last thirty years. As discussed by Michela Cerimele (chapter 6) on the basis of an extended field study on industrial work in the Vietnamese Red River delta, industrial employment continues to represent a temporary phase in the life trajectory of industrial workers. A young and predominantly female migrant labor force is absorbed by export-led companies in garments and electronics—but these workers either leave voluntarily due to exhaustion or are in fact expelled when they turn thirty or thirty-five. Minimum wages are very low, and employees depend on overtime work and (discretionary) bonuses to reach a salary that can lift them and their households out of poverty. However, even the full salary is not enough to support a worker's household in the peri-urban industrial areas where the industrial parks are located. This means that most workers have to send their children back to their rural villages and entrust them to the care of grandparents or other relatives. In other terms, there is a separation between industrial production and the reproduction of labor.[5]

This recent Vietnamese case study confirms a large literature on other Southeast Asian countries, particularly Thailand, Malaysia, and Indonesia, in which export-led industrialization has played a prominent role since the mid-1980s. In the 1990s, when the inclusion of Southeast Asia was still a recent phenomenon and confidence prevailed, only a few scholars foresaw

the uneven nature of Southeast Asia's industrial development (Parnwell 1996; Dixon and Drakakis-Smith 1997). Even studies that were more optimistic that industrial development might contribute to poverty reduction, however, revealed the apparent paradoxes of that industrialization process. On the one hand, the experience of industrial employment contributed to changing the identity of workers but did not imply a permanent transition out of agriculture and rural life. Industrial work was a life experience for young people—almost a rite of passage—but in most cases did not evolve into permanent employment.

> There is certainly some evidence to support the contention that off-farm wage labouring is a *rite de passage* in some rural areas of Southeast Asia. The process of *merantau* among the Minangkabau of West Sumatra, of *pai thiaw* in Thailand, and of *bejalai* among the Iban of East Malaysia, are partially founded on the belief that migration is bound up in the process of attaining maturity. (Rigg 1997, 184)

On the other hand, already in the mid-1990s it became clear that, while in the West and in the first generation of Asian NIEs the industrialization process involved a movement of people towards urban centers, thus helping to create a truly industrial proletariat and new industrial cities, this process was much more limited in Southeast Asia. In the Thai case, for instance, the unevenness of the industrialization process was also revealed by the creation of extended metropolitan regions, which kept the new industrial workers suspended in a limbo between urban and rural areas (Luxmon 1997). The same pattern is described by Cerimele at the Thang Long Industrial Park, which is nominally near Hanoi but is de facto so far that industrial workers feel completely estranged from the Vietnamese capital city (see chapter 6). Interestingly, so-called informal workers such as peddlers and construction workers seem to be much more integrated into urban life.

> Work in the informal sector embodies many of the same characteristics as that in the low-wage formal sector. But the workers are, by contrast, tightly bound into the operation of the city. They tend to interact more with other city residents at a social level; they live in slum or squatter accommodation which, though of poor quality, is an integral part of the physical fabric of the city; they are more likely to bring their families and make use of services like schooling and health facilities; and they spend (rather than remit) more of their earnings in the city. In short, while workers in many factories and in some types of casual work are semi-detached from the social and economic processes that give the city life, those in the informal sector are fully integrated into its functioning. (Rigg 1997, 262)

After over thirty years of Southeast Asian's close integration in the regional production system the precarious and vulnerable conditions of the industrial labor force can no longer be understood as a temporary pain. There is a pattern here that must be recognized as an inherent modality of inclusion of this region in the wider economy. The statistics provided by the International Labour Organization, for instance, reveal that while labor productivity has substantially increased, industrial wages in Southeast Asia have increased very little in the 2000s (ILO 2013).

Interestingly, Southeast Asia compares quite negatively with China in this regard. In China the government was able to promote policies supporting industrial upgrading and to simultaneously increase industrial salaries on the order of 10 percent per year. The higher Chinese cost of labor is, in fact, the cause of a further delocalization process of labor-intensive productions towards Southeast Asia. Probably the most notable example of this new delocalization wave is the transfer to two Vietnamese factories of the entire assemblage of Samsung mobile phones, an operation so important that by 2014 mobile phones became the largest export item for the Vietnamese economy.

While Southeast Asia continues to play an important role in global industrial production chains, its labor remains precarious and vulnerable, with limited improvement in working and living conditions. Remarkably, the separation of industrial production and the reproduction of labor seems to be a characteristic feature of this development model. A meaningful explanation of this phenomenon can be found in Marxist analysis of capital-labor relations. While capitalist development tends to expand the levels of proletarianization, this outcome is not desirable for the capitalists as it increases production costs. Semi-proletarianization—in which only part of the household is involved in industrial work, while another part operates outside the realm of monetary exchange—allows a reduction in the cost of labor reproduction, and therefore, in the overall costs of industrial labor. As Immanuel Wallerstein suggests, capitalist forces tend to delocalize labor-intensive operations towards regions in which the process of proletarianization is due to remain limited. This seems to be exactly the case of Southeast Asia.

> [The] geographical expansion of the world-system served to counterbalance the profit-reducing process of increased proletarianization, by incorporating new work forces destined to be semi-proletarianized. (Wallerstein 1995, 39)

Semi-proletarianization represents an advantage for foreign investors and their subcontractors, as the costs for labor reproduction can be externalized. However, the attempt of Southeast Asian countries to increase the level of industrial employment through participation in global production networks creates a space for further coercive processes (D. Chang 2006). Countries are required to offer incentives, tax rebates, and pro-capital policies (that is, suppression of workers' rights) in order to attract foreign investment.

> The competition between economies is a hallmark of transnational investment and production as governments and local businesses seek to attract financial capital, investment, and production. States

> promote their territories for the advantages they offer in cheap, skilled, and/or controlled and disciplined labor; access to markets and materials; tax advantages, and so on. Many states maintain offices that promote the business-friendliness of policies within their jurisdictions. Such policies have been implemented so broadly that they are now seen as orthodoxy; they are the "natural" policies for delivering progress and development. (Kalleberg and Hewison 2012, 277)

Transnational corporations sometimes ask that the states provide basic social services to the industrial workers, transferring to the states costs that companies neither want to address nor cover directly, such as housing, kindergarten, and health care, by increasing industrial wages. More typically, however, the pressure is towards policies that suppress workers' rights and repress efforts to organize labor. The attempt to suppress labor rights and labor organizing is a constant feature of capitalist strategies. However, the Southeast Asian countries have developed differently from the East Asian NIEs. In the Asian NIEs, as suggested by modernization theory, industrial wages and working conditions improved when the "reserve army" of unoccupied rural labor declined as industrial employment absorbed more and more workers. In Southeast Asia, on the contrary, the limited expansion of industrial employment and the partial proletarianization of industrial workers was the result—and a cause—of persisting high levels of relative poverty and inequality. Even in the most "successful" Southeast Asian countries these contradictions persist. For example, FDI-led industrialization has allowed Thailand to become the eleventh largest automotive producer worldwide and a major exporter. However, poverty and inequality continue to characterize Thai economic development.

> The continuing high rates of poverty and inequality, far from being an accidental "side effect" of export-led accumulation, are a basic condition of this accumulation. The Thai state has supported policies designed to depress agriculture prices to force rural workers,

> who make up the majority of the Thai population, into seeking employment in the urban-based export industries. . . . It also gives rise to another major source of inequality and human misery, the country's huge, foreign exchange earning, sex-tourism sector, which employs some 13 percent of the total female labor force (Petras and Wongchaisuwan 1993, 36). Thailand's epidemic of HIV and AIDS is directly connected to this hypertrophied sex-tourism industry. (Hart-Landsberg and Burkett 1998, 104)

The dependent development model of industrialization adopted by Southeast Asian countries has as a necessary consequence an uneven model of social development, in which labor precariousness and vulnerability is accompanied by high levels of inequality.

> The need to exploit cheap labor and the environment for growth is rooted in the imperative to increase export earnings by any and all available means—an imperative built into the peripheral export-led growth strategy, with its dependence on imported components, technologies, and business services from the core and semiperiphery. (Hart-Landsberg and Burkett 1998, 104)

The deep integration of Southeast Asian economies in the regional production order for over thirty years has not changed this reality. The Thai trade balance continues to show a very large deficit with Japan as the automotive industry continues to depend on imports from Japan for most of the value-adding components. The Vietnamese trade balance shows massive imports from Asia and subsequent exports of finished goods to the rich markets of North America and the European Union in a process that brings rather limited benefits to the Vietnamese economy. Under these conditions, a cheap and well-disciplined labor force remains the main competitive factor.

Conclusion

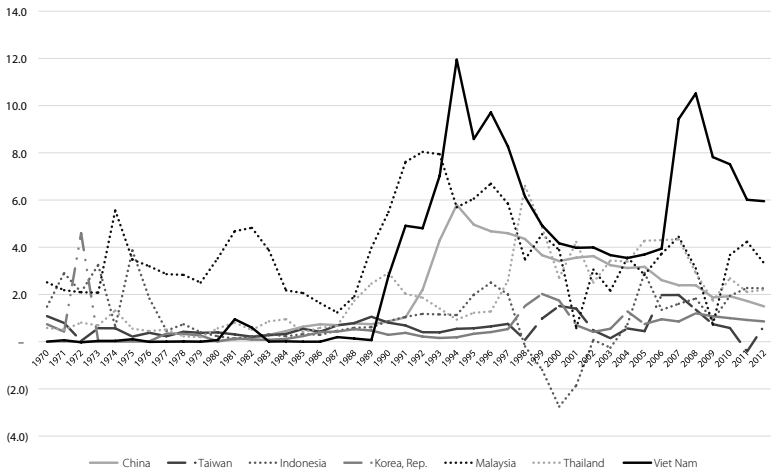
This chapter has presented a critical review of the renewed World Bank attempt to create a hegemonic consensus on economic development in Southeast Asia through the "middle-income trap" discourse. I have argued that the middle-income trap discourse is not only intellectually flawed but is also dangerous because it aims at promoting an economic reform agenda that could further aggravate the problems faced by Southeast Asian countries. In particular, the World Bank support of the neoliberal attempt to further deregulate the labor market risks making even more miserable the lives of millions of industrial workers who are already facing precarity and vulnerability. I have provided an alternative analysis of the causes that prevented Southeast Asia from repeating the so-called Asian miracle and did not allow even the most successful countries in the region to catch up with industrialized countries in terms of GDP per capita. These causes are broadly connected with modalities of industrial development that are excessively dependent on FDI, within a hierarchically organized regional production system. This dependent industrialization creates major and *persistent* obstacles for upgrading and climbing the value chain, forcing local firms—and, indeed, entire countries—to continue competing internationally on the basis of low labor costs. This model has resulted, during the last thirty years, in a pattern of uneven development, with high social costs and increased dependence on international capital. For these reasons, I propose adopting an alternative definition of dependent industrialization and the uneven development trap that better addresses the contradiction faced by the region.

Notes

1. This title is inspired by Wade 1996.

2. Figure 7.3 shows the high dependence on FDI of the ASEAN 3 and, most recently, Vietnam, when compared to the Asian NIEs and China.

Fig. 7.3. FDI inflows as a percentage of GDP



3. This applies also to the Thai case. Even if Thailand was never a colony, its economy was negatively affected by the distortions created by the dominant influence of foreign powers. The Japanese colonization of Taiwan and Korea was equally hard, but it was unique in its contribution to the creation of heavy industry and the diffusion of an industrial culture. See Cumings (1984).

4. With the notable expectation of the city-state of Singapore, in which foreign direct investment has been used, under strong guidance from the government, to replace the almost nonexistent private capital along a strong state sector (see H. Chang 2006).

5. Or reproduction of labor power. "The cycle of reproduction of labour is the process whereby labour is applied to the production of the means of life, and consumed, restoring the labourers' capacity to work again. This cycle occurs both on a day-by-day basis as well as generation-after-generation." Encyclopaedia of Marxism (www.marxists.org).

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