

The background of the entire page is a dense, overlapping collage of various international coins. Visible denominations include 100, 50, 20, 10, and 5 cents. Countries like Malaysia (Negara Melayu), the United States (Liberty, Union, Justice, Under Law), and Mexico (Libertad) are identifiable. The coins are in various orientations and colors, including silver, gold, and copper.

Huzaima Hamid

The
Formula
for
National
Wealth

HOW DEVELOPING
COUNTRIES CAN
ATTAIN DEVELOPED
STATUS



The Formula for National Wealth

HOW DEVELOPING
COUNTRIES CAN ATTAIN
DEVELOPED STATUS

Huzaima Hamid

PUSTAKA PERDANA



1013619



UNIVERSITI
MALAYA
PRESS

KUALA LUMPUR • 2024



Published by
Universiti Malaya Press
Universiti Malaya
50603 Kuala Lumpur
www.umpress.com.my

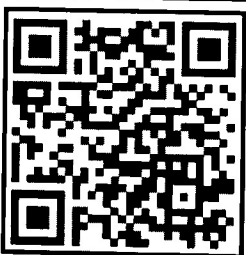
General/Commercial Category

DOI: 10.14425/9789674883256

Founding Member of Malaysian Book Publishers Association—Membership No: 196906
Founding Member of Malaysian Scholarly Publishing Council

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Cataloguing-in-Publication Data

Perpustakaan Negara Malaysia

A catalogue record for this book is available
from the National Library of Malaysia

ISBN 978-967-488-325-6

Printed by
Universiti Malaya Press
Universiti Malaya
50603 Kuala Lumpur

Contents

<i>List of Figures and Tables</i>	<i>vii</i>
<i>Preface</i>	<i>ix</i>
1 How Economies Move Upward	1
2 Less Developed or Developing – What’s in a Label?	5
3 A Matter of Perspective	11
4 A Note on ‘Productivity’	15
5 The Political Economy of Old Great Britain (or How They Became an Advanced Economy)	19
6 The Path the U.S. Took	33
7 South Korea – The Speed Merchants	39
8 Declarations of Intent – Venice, Austria, Australia and China	47
9 Protecting Domestic Industries	55
10 Germany / Austria (Deutschland / Österreich)	67
11 The Results	71
12 Industrialisation	73
13 The Stepladder/ Industrial Sequencing	83
References	91
Index	95



List of Figures and Tables

Figures

Figure 2.1:	UN Development Programme Human Development Index Principles	9
Figure 5.1:	British economic ascendancy strategies by List	24
Figure 7.1:	Tariff Rates Reduction under Korea's Tariff Reform Act 1984	43

Tables

Table 7.1:	Korea's Industrialisation by Sector (Knox, Agnew, McCarthy 2003)	41
Table 9.1:	Average tariff rates on manufactured products in selected developed countries, 1820–1987 (weighted average; in percentages of value)	56
Table 9.2:	Comparison of Two Ideal Types of Protectionism	60
Table 11.1:	South Korea's GDP in US Dollars, GDP Growth, and GDP per capita, 1980–1997	72
Table 12.1:	Differences Between Manufacturing and Agriculture	80

Table 13.1:	Britain's, USA's, and Japan's Paths to Development	84
Table 13.2:	Korea's Rapid Rise (Knox, Agnew, McCarthy 2003)	85

Preface

This is the culmination of a 20-year personal quest. When I exited the capital markets as a fund manager after 12 years and moved into the world of intellectuals, I unknowingly moved from the world of judging economies that I was investing in to thinking about why economies are different from each other, and as a Malaysian thrust into public policy advisory, what it would take for my own (developing) country to become an economy that was as strong as America, at one time the world's leading economy.

I had seen the Korean economy take great strides towards very rich country status (that their economy was smaller than Malaysia's in 1957 is mind-boggling); Singapore's currency tripling in value against the Malaysian Ringgit when it was at parity in 1963; and of course, China's awesome rise to a global economic superpower from a poverty-ridden, famine ravaged country prior to 1990.

I kept asking myself, if they can do it, why not us? Neither South Korea or Singapore have much in terms of natural resources; South Korea had, at one time, a population the same size as Malaysia, and China flipped from being a Command Economy to State Capitalism and consequently, the economy shot upwards with mind-blowing speed.

So began my quest. I was a baby in the woods when I started, and my formal training in Keynesianism, Neo-Keynesianism, Monetarism, Financial Macroeconomics, and Classical Economics did not give me the answers I was looking for. There were no books on it either, I was reliably told. I was lost for many years.

Meanwhile, Malaysia was stuck in the Middle Income Trap.

Then, I met German and Austrian economists. They thought differently, quite unlike how I had been trained to think. I started to search in old German and Austrian books in economics, after a learned Korean economist pointed out where the secrets may be. I speak passable German acquired in college, and it helped.

Quite accidentally, I found Friedrich List. And then Von Mises. Boehm-Bäwerk. Schumpeter. Engels. Hayek. In short, I found The Austrian School – and the answers. It was as if all the spotlights in a stadium had been turned on.

I read everything I could find that the Masters of the Austrian School had written, and present in this book a summary of those great minds' works, and how their thoughts had built so many advanced economies. Many of those countries rank at the top of the world's Happiest Countries and Most Liveable Countries lists and are also some of the most powerful economies on the planet.

The thoughts of many great economists, as you will read in this book, form a similar pattern, and hence, a workable plan for advancing a nation to developed status. A long list of developed nations stand as testimony to the accuracy of this blueprint. Key points have been put in bold for emphasis and for ease of reference.

Perhaps one day, the only difference between any country in the world will be its cultural characteristics, and not its wealth, opportunities, advancement directions, liveability, or standard of living. Peace would be omnipresent. This is the dream, I daresay, of all economists, be they novice or Master. Economics, after all, seeks stability. We have to work towards it, though.

Huzaimé Hamid
Kuala Lumpur

“Whoever is not yet convinced that by means of diligence, skill, and economy every branch of industry must become profitable in time – that in every nation already advanced in agriculture and civilisation, by means of moderate protection, its infant manufactures, however defective and dear their protection at first may be, can, by practice, experience, and internal competition readily attain ability to equal in every respect the older productions of their foreign competitors; whoever is ignorant that the success of one particular branch of industry depends on that of several other branches, or to what a high degree a nation can develop its productive powers, if she takes care that each successive generation shall continue the work of industry where former generations have left it; let him first study the history of English industry before he ventures to frame theoretical systems, or to give counsel to practical statesmen to whose hands is given the power of promoting the weal or the woe of nations.”

Friedrich List

Austrian School of Economics

The National System of Political Economy 1841



1

How Economies Move Upward

The stages of economic growth, as Porter (1990) states, emphasise competitiveness. This is important, for without competitiveness, companies and the economies will not only stagnate but will eventually be destroyed either via foreign competitors competition or through consumer neglect.

Economies begin when humans start trying to fulfil needs, and for this purpose, begin to trade. As the need to develop and differentiate more and more to meet the needs of the country, governments ponder how best to raise their economies.

Porter presents the economic development process in stages, as compared to the conventional Less-Developed, Developing, and Developed categories:

Stage 1 – Factor Driven

- Country competes solely on prices;
- Sources technology from foreigners, usually inexpensive and widely available;
- Products tend to have little product or process technology that is inexpensive;
- Foreign firms provide most of the access to foreign markets; and
- Few nations ever move beyond this stage.

Stage 2 – Investment Driven

- National competitiveness is based on the willingness and ability of a nation to invest aggressively;
- Investments are made to obtain modern, efficient, and often large-scale facilities with cutting edge technology;
- In addition, investments are made to obtain foreign product and process technology via licences and other means to compete in ever more sophisticated industries and segments;
- This is the critical stage where technology obtained is typically one generation behind and local companies can improve on it;
- A nation upgrades its competitive advantage due more to supply push rather than demand pull as household demand is still relatively simple while incomes remain modest; and
- Protection must be temporary despite inevitable pressure to make it permanent, as temporariness is needed to spur improvement and innovation.

Stage 3 – Innovation Driven

- Growing competitive strength at home leads to ever more sophisticated domestic industrial and retail customers;
- Vibrant domestic rivalry in many industries, accelerating improvement and innovation;
- World-class supporting industries develop in industrial segments/clusters;
- New competitive industries emerge out of related industries;
- Competitive advantage due to costs becomes rare; instead selective factor disadvantages stimulate innovation to overcome them that advance product and process technology; and
- Government's role changes as allocation of capital, protection, licensing controls, export subsidy, and other forms of direct intervention lose relevance or effectiveness; in fact, governments would do better in indirect ways such as simulating the creation of more advance factors, improving the quality of domestic demand, etc.; while firms take the lead in factor creation.

Porter notes that the stages of economic development can take many paths, and there is no single progression template or timetable. Development is not a smooth, 45-degree upward slashing path; it often seems to occur in bursts of rapid upgrading, followed by periods of less perceptible change.

Porter further states that achieving competitive advantage in industrial and supporting sectors requires a base of strong indigenous companies and higher levels of technological capability. In other words, the start matters.

2

Less Developed or Developing – What’s in a Label?

How does one define a ‘Developing Country’? During my studies in the United States in the 1980s, I was introduced to the concepts of ‘Developed Country’, ‘Developing Country’, and ‘Less Developed Country’. A ‘Developed Country’ was the best country one could live in. Not only were incomes higher, but quality of life was the best around. ‘Less Developed Countries’ or ‘LDCs’, were generally poor countries whose residents would struggle through life, living on US\$1 to US\$2 a day. Grim pictures often accompany descriptions of LDCs; such as starving, dying children of Ethiopia, whose images flashed to the world in the mid-1980s sparked horror and a global movement to feed the poor countries. ‘Developing Countries’ were generally everything in between. Nonetheless, the range of economies in that category was so broad that other sub-categories such as ‘Lower’, ‘Middle’, and ‘Upper’ popped up.

Metrics weren’t much in use or very specific then, and when one wants to determine the quality of life, metrics get even fuzzier.

Whenever I am asked about ‘Developed Countries’, I usually answer that they were already accepted into the OECD (Organisation for Economic Cooperation and Development), a rich nations club, rather than state a specific GDP (Gross Domestic Product) level. Still, even within the OECD, some of the members’ GDP levels are lower than some Developing Countries, which raises further questions of definition.

Nonetheless, when it came to development sciences, we were typically taught to look at how Less Developed Countries developed, namely the use of ‘Factor Addition’, i.e., the factors or elements of the economy that are added

or increased. The factors that we were taught were of capital, labour, and natural endowments or resources. Later on, entrepreneurship was added. Increases in or new discoveries of resources help economic growth. Keep adding and bettering, and you would grow richer, was the mantra.

Businesses were hardly mentioned. Subsequently, neither was manufacturing and industries. It was assumed that the economy would take shape in the industries it had resources for or grew into. All this, of course, was based on Keynesian economics or Classical Economics.

'Developed Countries' was always presented as a goal, a Nirvana or an Utopia, if you will, and consequently, not much was said about them, or how to get there. Basically, the message was, keep developing from Less Developed status and eventually, you'll get to be rich. That left the matter of how a country goes through the 'Developing Country' stage from 'Less Developed' up in the air. As one reads through, one will find a multitude of tactics and strategies that have to be applied, at the appropriate time.. 'Free trade' often used to advise Developing Countries as a means of becoming more developed, is a poisonous chalice, as you will read later in this book.

The true, proven answers lay in the writings of the Masters of the Austrian School of Economics as they were writing, largely, when Austria was a Developing Country, trying to catch up with then already developed Great Britain. Furthermore, the history of how Developed Countries became rich was telling; a similar pattern emerges.

Here's the revelation: Great Britain's great economists, from Adam Smith, Lord John Maynard Keynes, and David Ricardo were all writing in the context of a Developed Country, not a Developing one. Little wonder then that their work is neither adequate nor suitable for Developing Countries.

An example of such misapplication is thus: Keynes' key advice was for governments to spend on infrastructure building during slumps in economic growth. For Developed Countries, that is all well and fine, as they have large affordable user capacity and in many cases, aged infrastructure (the U.S. has budgeted US\$2 trillion for its Infrastructure Plan from 2021). For Developing Countries with poorer populations, however, that is likely to lead to many 'white elephant' projects, i.e., unused, wasteful projects. In short, economics for Developing Countries should follow that which was written for them, and not for Developed Countries.

The Austrian School of Economics has had a great track record in developing countries, from Austria to Germany, Switzerland, the Low Countries of Europe, the Scandinavian countries, Japan, and China, to name a few.

As confusing as the definitions of countries are, the definition of an economic growth path is even more so. The following are three contemporary examples.

E. Helpman in his 2004 book *The Mystery of Economic Growth* examined key economic growth factors, such as:

1. Accumulation,
2. Productivity,
3. Innovation,
4. Interdependence,
5. Inequality, and
6. Institutions and politics.

He found that each factor could not exclusively explain why a country develops economically but stressed the importance of 'institutions', which he defined as 'rules of the game' and called for further studies on political economy.

W.W. Rostow in his 1959 book, *The Stages Of Economic Growth: A Non-Communist Manifesto*, noted the following the stages:

1. Traditional Society – guided by ancient traditional economic methodology, causing low output that doesn't change much, Pre-conditions for 'Take-Off' stage – a transitional period where traditional methods are replaced by modern methods and products,
2. 'Take-Off' stage where traditional methods and obstacles are overcome and the country enters a steady state of growth,
3. 'Drive To Maturity' – the stage of increasing sophistication of the economy. The economy is able to move beyond the original industries that had powered its take-off and is now utilising edge-of-the-envelope technology and innovativeness, and
4. Stage of 'High Mass Consumption' with an affluent population, sophisticated consumer goods, and the services sector as the largest industry in the economy.

To add to the smorgasbord of definitions, management guru Michael Porter (1990) in his book *Competitive Advantage of Nations* pointed out the following stages of development a nation undergoes in order to become a Developed Nation:

1. Factor driven stage – a nation uses endowments of labour and natural resources exclusively,
2. Investment driven stage – efficiency in producing standard products and services that are a dominant source of competitive advantage. They

- earn higher wages but are susceptible to financial crises and external demand shocks, and
3. Innovation driven stage – the dominant source of competitive advantage is the ability to produce innovative cutting-edge products and services.

While it is intellectually brilliant, it doesn't provide much in terms of quantitative targets.

Realising this, perhaps, the World Bank has issued quantitative targets for economic development stages. They are called 'Low Income', 'Middle Income', and 'High Income' nations using GNI (Gross National Income) per capita.

Focusing on the Middle Income category, we find the quantitative range very wide, from US\$1,036 to US\$12,535 GNI per capita, a mind-boggling range.

Many years ago, several quantitative measures of the level of a country's development were set out by big MNOs (Multi National Organisations), such as:

1. The number of households with radios,
2. Televisions sets in households,
3. Percent of the population living on US\$1 or US\$2 a day,
4. Access to clean water,
5. Proper sanitation facilities,
6. Access to education/ education facilities, and
7. Medical care, etc.

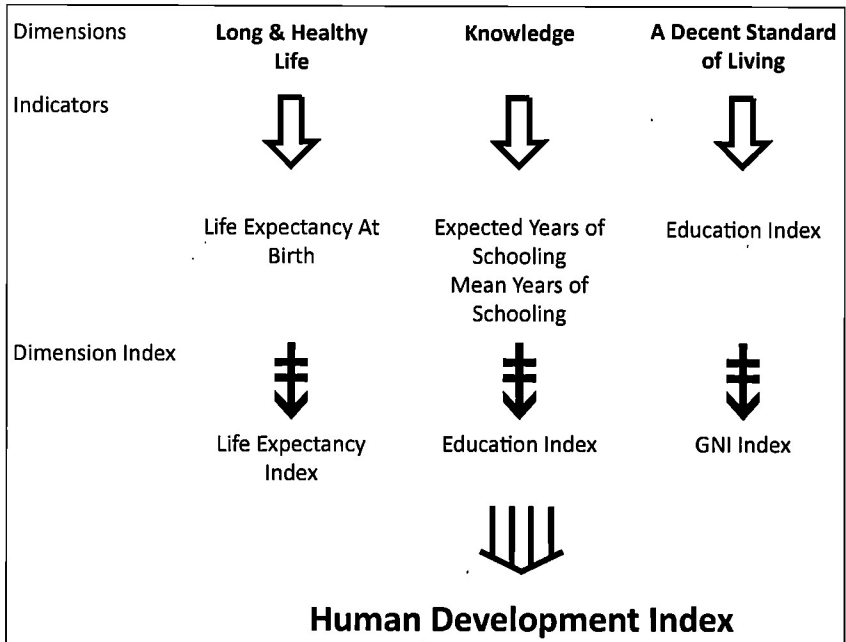
These became the standards by which countries would show how far they have come in developing living standards for their citizens.

As countries developed, these statistics were transformed, as illustrated in Figure 2.1 on the principles of the United Nations (UN) Human Development Index.

An interesting development has been the inclusion of the country's fundamental human rights treaties, such as ICERD (International Convention on the Elimination of all forms of Racial Discrimination, 1965) and ICPEP (International Convention for the Protection of all Persons from Enforced Disappearance, 2008).

However, much of whether a person is well taken care of or not is quite unquantifiable and subjective. For example, surveys on the "World's Happiest Countries" swing away from just numbers, and tend to be how a country's institutions takes care of its people (*Forbes* 2022).

Figure 2.1: UN Development Programme Human Development Index Principles



Source: Adapted from the UN Development Program (UNDP) Human Development Report

Hence, the wheel has turned full circle and we are back to looking at things from an economic viewpoint.

3

A Matter of Perspective

One of the perplexing things about studying economics is that one doesn't come across a methodology for moving from developing country to developed. As mentioned earlier, the role of businesses is largely absent.

Generally, discussions on less developed countries and the factors leading to their development tend to stop short of what a developing country needs to do to become a developed nation. The discussion then tends to leap towards what developing countries do or ought to do.

Here's the rub: if a developing country follows the prescribed policy actions meant for developed countries, the results would most likely be wasteful and at best, sub-optimal. For example, Lord Keynes' famous advice for spurring demand is for governments to spend on infrastructure. That would work well for developed countries whose industrial potential and capacity have maxed out and, presumably, whose infrastructure is old and in need of replacement. The U.S. is in fact, doing this at the time of writing with its US\$2 trillion Infrastructure Plan. That Keynes' advice was made in the wake of the 1930s U.S. Great Depression which affected all developed countries also adds another level of context: that it was done during sharp slowdowns (like what the U.S. is facing) speaks of its rarity of use and of expected optimal outcomes.

Contrast that with developing countries using that same advice. Their usage of infrastructure has probably not reached its limit, hence, additional infrastructure spending will most likely lead to the creation of roads, ports,

and airports that would be underused as well as many ‘white elephant’ buildings” that lie mostly empty and unused.

This brings us to the matter of perspectives of writers of economics. Adam Smith and John Keynes were mainly writing for their home economies at the time. Even during the time of Adam Smith (1723 to 1790), Great Britain was the most advanced nation then, as it was during Keynes’ time (1883 to 1946). Thus, it would be logical to assume that the advice and prescriptions were for developed countries.

By contrast, the Austrian School economists were writing at a time when their countries were developing and desired, as stated many times in their papers, to overtake Great Britain economically.

The Austrian School was acknowledged as having been ‘started’ by Carl Menger (1840 to 1921), and consists of famous economists such as Friedrich List (1789 to 1846), Joseph Schumpeter (1883 to 1950), Eugen Boehm-Bäwerk (1851 to 1914), Ludwig von Mises (1881 to 1973) and Friedrich Hayek (1899 to 1992), among others.

As to why the knowledge is hardly used in the Western world, the answer is simply that Western institutions of knowledge would naturally be pre-occupied with their current situation, not of history. The past is, well, the past.

It is then up to the developing world’s institutions of knowledge to use this golden egg of ‘how to’, to suit their needs, and prosper from it.

The Economist (2023) put it well when it said,

“Scarcely had Britain’s Industrial Revolution got going when Alexander Hamilton, America’s first Treasury secretary, argued for protection of his country’s industry, declaring that Adam Smith’s arguments in favour of free trade ‘though ‘geometrically true’ are ‘practically false’. America, France, and Germany industrialised behind tariff barriers. After the Second World War scores of governments tried to help industrialisation along, with seeming success in places like Japan and South Korea, and rather different results elsewhere.”Does the way up for countries matter nowadays to the developed countries? That’s a matter of perspective, too.”

Friedrich List (2011) said,

“It is a very common clever device that when anyone has attained the summit of greatness, he kicks away the ladder by which he has climbed up, in order to deprive others of the means of climbing up after him.”

However, one must question whether such knowledge is passé for the achiever, and that a country's resources are better spent on progressing the country.

How advanced economies view economic development not only dominates economic thinking, but voids the necessary steps that developing countries must take to establish a base to take on developed country challenges.

Porter (1990) best exemplified this when he said,

"Economies progress by upgrading their competitive positions through achieving higher order competitive advantages in existing industries and developing the capability to compete successfully in new, high productivity segments and industries."

Trade, which exports from productive industries allow imports of products that could be produced in the nation only at lower productivity, is essential to the upgrading process. So is FDI that shifts less productive activities abroad or that allows high productive industries to better penetrate foreign markets. (Author's note: This kills the prospects of recipient economies, usually leaving them as is or stuck in the Middle Income Trap.)

Part and parcel of the upgrading process is loss of position in price-sensitive segments and in products involving less sophisticated skills and technology. (Author's note: This is basically Schumpeter's 'Creative Destruction' at work.)

Yet, the process also works in reverse. The inability to improve and innovate fast enough to sustain position in advanced industries and segments can undermine position in others.

Without the ability to export (and sustain position against imports) in a range of such industries, national productivity growth will be stunted. The capacity to export in advanced industries, which allow imports in less productive fields, is also fundamental to the upgrading process." (Author's note: This is why rich countries pushed so hard for the formation of the World Trade Organisation, WTO.)



4

A Note on ‘Productivity’

Total Factor Productivity or ‘TFP’ is a measure of the amount of output that can be produced from a certain amount of inputs, generally speaking. However, it is actually an abstract concept trying to measure the amount of goods produced that cannot be explained by the amount of inputs used in production.

For many years, TFP was a yardstick on how to measure a country’s development progress. However, further research has cast doubts on the utility and veracity of the use of TFP as an ultimate measure of economic growth.

A 2019 paper by Goswami, Medvedev, and Olafsen published by the World Bank (Goswami, Medvedev and Olafsen 2019), for example, noted that studies on high-growth firms found it was difficult to pinpoint the causes of high growth, whether they were due to greater efficiency or other factors, like raising prices. This rendered a difficult to grasp quality to TFP and its use was abandoned.

A worrying thing was that economies started thinking TFP was the only metric that had to be chased in order to develop an economy. It certainly isn’t. New goods, services, and products play a crucial role; in other words, factor addition.

Austrian economist Schumpeter stated in 1934 (Schumpeter 2012):

“Development in our sense is then defined by the carrying out of new combinations. This concept covers the following:

1. *The introduction of a new good – which new consumers are not yet familiar with – or of a new quality of a good;*
2. *The introduction of a new method of production, that is one not yet tested by experience in the branch of manufactures concerned, which by no means be founded upon a discovery scientifically new, and can also exist in a new way of handling a commodity commercially;*
3. *The opening of a new market, that is, a market into which the particular branch of manufacture of the country in question has not previously entered, whether or not this market has existed before;*
4. *The conquest of a new source of supply of raw materials or half-manufactured goods, again irrespective of whether this source already exists or whether it has first to be created; and*
5. *The carrying out of the new organisation of any industry, like the creation of a monopoly position (for example, through trustification) or the breaking up of a monopoly position.”*

Porter further added in 1990 that,

“An upgrading economy is one which has the capability of competing successfully in entirely new and sophisticated industries.”

This suggests new firms with new products and/ or services. Porter's thoughts, more than 55 years later, is in line with Schumpeter's.

Another issue with TFP is that it means different things to developing countries and developed countries. Imagine that two countries with the same productivity rate of 10% in a year, but one is a developing one with a GDP of US\$10 trillion a year, while the other is a developed one with a GDP of US\$100 trillion. A 10% rate of productivity in a year means only an additional US\$1 trillion for the developing one, but US\$10 trillion for the developed country. This means the developed country has gained the equivalent of the developing country's GDP in a year!. In short, productivity/ TFP numbers do not translate well in absolute terms for a developing country, much less for a poor country.

Finally, there is also the Solow/ Productivity Paradox, which, simply put, would not be explained in the 1970s and 1980s when productivity in the U.S. fell despite the introduction of new information technologies (computers, for example) that were supposed to leap U.S. productivity upwards (Wikipedia

2022). These cast doubts on the integrity and accuracy of TFP as a yardstick of development growth.

Ever wonder why some economies make it past the Developing Country stage and most don't? Looking at the economic history of many countries that made it, the UK, the US, Japan, South Korea, Australia, Germany, Austria, and even China, to name a few, and a familiar pattern emerges.

Why aren't Developed Countries propagating this? Simple, it is the past for them. They would focus on their path at current, as Developed Countries. It then behooves Developing Countries to seek this knowledge out and practice it, keeping it alive for others to benefit from.

Here is the 'stepladder' laid out, for any country to emulate, with the right local changes, and you are on your way.

Huzaima Hamid is the Chairman and CEO, as well as the founder of Malaysia's financial macroeconomic advisory, Ingenium Advisors. He has more than 30 years' experience in finance, macroeconomics, and public policy advisory at international level. He is happy to share his knowledge with nations of the world and the movers and shakers who want to make the world a better place.



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