

These notes have been written, in view of repeated questions put to me about the subject matter by economists in Asia and journalists there as well, so as to go with my Cornell paper on: "The Miracle that did Happen: Understanding East Asia in Comparative Perspective", which is on my website: <http://www.columbia.edu/~jb38>. I had argued there that there was indeed a miracle, contrary to what Krugman had argued. I restate & add to some of the arguments there, especially as the recent financial and economic crisis has created the illusion that this shows that Krugman was right in claiming that the "mythical" miracle would in any case drown under "diminishing returns".

1. His Thesis

Fact 1. Asia has grown at very high growth rates.

Problem: Does it mean that there was a "miracle"?

Krugman claims that there is no miracle in Asia's exceptionally high growth rates because it is to be explained by high investment rates.

He is wrong. **Two definitions of miracle**: (1) you cannot explain the miracle by rational argumentation; and (2) the phenomenon is "exceptional", "spectacular", "off the charts", etc....

By both definitions, Krugman is wrong.

First definition: the miracle is explained, by Krugman himself (drawing on the work of Allwyn Young, who was a Columbia student), as "due to" exceptional investment rates rather than exceptional or high technical progress.

Second definition: the growth rates, and in turn the investment rates, are truly exceptional : no other group of countries, in any historical period, have ever had such high growth rates of income and of productive investment over a sustained period of 2-3 decades.

Fact 2: Krugman claims that, since the Asian growth depends on investment rather than technical progress, it will slow down because, according to the law of diminishing returns, if you accumulate capital relative to labour, you get lower returns to capital, i.e. the added income you get from more investment is steadily less. So, high rates of investment begin to yield lower income growth. I.e. Asian “miracle” growth rates of income will vanish soon “due to diminishing returns”.

Krugman is wrong: First, other researchers have found that, if you make estimates decade by decade, instead of for 3 decades together, then you can detect that these economies are improving their technical change. This is to be expected. Almost everyone starts by first learning to do things by “reverse engineering”, i.e. taking a watch apart and putting it back together; then they graduate to inventing marginal improvements in products and processes; then they innovate in products (e.g. Japan invents Sony Walkman now) & then take to inventing new processes and technologies (e.g. digital technology). So, naturally these splendid economies also should show increasing technical achievements, especially in industry.

Second, the interesting observation is that “diminishing returns” did not set in for 3 decades, when in fact Krugman would have said 3 decades ago what he says now: that “soon” or “some day” diminishing returns will set in! That also suggests that technical change cannot have been absent or negligible in the later stages of the Asian miracle

Fact 3: The Asian economies are now in a bad crisis.

Journalistic Contention: This proves that Krugman was right.

This **contention is wrong**: Why? Because these economies did not experience “diminishing returns to capital accumulation” but instead suffered a panic-driven crisis where capital flew out in huge quantities and imposed huge economic and social costs.

If Krugman’s prognosis had been correct, you would have observed a **slow and continuous slowing** of growth rates as capital accumulated steadily. Instead, you got a **sharp and discontinuous decline** of growth rates, even negative growth rates in these countries. It would therefore be strange indeed to credit Krugman with being a “prophet” for Asia!

An appropriate analogy to show how unwittingly funny the journalists who applaud Krugman’s prescience are, would be:

If a Jesus freak walks up and down, proclaiming that a Biblical flood is near, and the world perishes because of a nuclear winter, that does not turn the freak from a wacko into a prophet! Needless to say, Krugman is generally no Jesus freak but is in fact a theorist of huge importance and is besides among my most distinguished students; but otherwise the analogy is totally apt.

A Side Comment: Krugman also compared the Asian situation to the Soviet experience, citing how diminishing returns had steadily reduced growth rates there too. But Krugman seems unaware of the scholarship on the Soviet decline. Econometric studies of Soviet decline, especially by Professor Padma Desai (see her Basil Blackwell book on The Soviet Economy, which reprints her articles from AER etc. and also see Chapter 1), show that the Soviet decline can be modeled almost as well in two ways: a diminishing returns story where the bulk of the blame is assigned to increasing accumulation relative to capital as Krugman believes, and a story where the bulk of the blame is assigned instead to declining efficiency to use of factors in whatever combination. Surely, the latter is the more intuitively consonant with what happened in Soviet Union: lack of incentives, economic and political, steadily and increasingly undercut the economy’s efficiency! To believe that what happened was a straightforward diminishing returns story would seem to me to be bordering on naïvete and ignorance of the voluminous scholarly literature on failing incentives to produce and invest efficiently and to innovate. So, I must reluctantly conclude that Krugman gets even the Soviet analogy wrong.

