# The 'Developmental State' and Economic Development

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**Describe the Attributes of the "developmental state" and Explain how these Attributes led to Highly Successful Economic Development in what some Scholars refer to as Newly Industrialized Countries (NICs).**

The term 'developmental state' has been incorrectly used to describe any state presiding over a period of economic development and improvement in living standards. The equating of a booming economy with a developmental state becomes problematic in cases where economies are heavily dependent on external factors, such as export of primary products or aid inflows. Rather, the developmental state not only refers to the collective economic and human development, but also describes the state's essential role in harnessing national resources and directing incentives through a distinctive policy-making process.

The developmental state has not been a novel concept, but it came into particularly sharp focus in Chalmers Johnson's account of Japan's Weberian ideal type of an interventionist state that joined private ownership with state guidance. Rather than presenting a causal explanation of Japan's economic boom, Johnson's MITI and the Japanese Miracle describes the totality of the Northeast Asian experience and seeks to understand the circumstances and impulses which shaped the institutions that created Japan's industrial policy. The Japanese use of market mechanisms for developmental goals has been successfully emulated in South Korea,Taiwan,Singapore, and Hong Kong. A comparative analysis of the Newly Industrialized Countries (NICs) allows variations of the developmental state to emerge from the background of the astonishing economic growth in East Asia. The experience of this region is evidentiary that the success of the developmental state stems from the amalgam 'embedded autonomy,' in which the developmental state is linked intimately with the private sector but preserves sufficient distance for the renegotiation of goals and policies when capital interests are inconsistent with national development.

According to Meredith Woo-Cummings in The Developmental State, Johnson situates East Asian development in the context of 'late development' and the East Asian setting of revolutionary nationalism, a distinct type of nationalism that arose from war and imperialism, which manifested itself in Japan, South Korea, and Taiwan (Woo-Cummings 21). In his book, Johnson writes that the Japanese state chose economic development as a way to ensure national survival: for most of the twentieth century, economic development was a means for 'overcoming depression, war preparations, war fighting, post-war reconstruction, and independence fromU.S.aid' (20). Nationalism was therefore a reality born from struggle with a stronger external power. For Johnson,Japanis a case of 'an economy mobilized for war but never demobilized during peacetime' (22). What was originally wartime nationalism transformed into economic nationalism, which sought to catch up and get even with the West, and which has lent legitimacy to the state's policies and goals and leverage in realising them.

State control of finance, Johnson argues, was the linchpin of the developmental state, followed by labour relations, autonomy of the economic bureaucracy, the combination of incentives and command structures, and the existence of the zaibatsu (or the Korean chaebol, or Chinese business groups). In Japan and South Korea, the state controlled interest rates and bank loans were the primary sources of industrial finance, as opposed to equity capital (25). The Japanese state substituted for a missing capital market in the post-war period, simultaneously helping to induce transformative investment decisions. The expansion of new industries depended on the state financial institutions'

 ISSN 2053-8626 

willingness to back industrial debt. The Ministry of International Trade and Industry (MITI) had the authority to approve investment loans from the Japan Development Bank, to allocate foreign currency for industrial purposes, to seek imports of modern technology and machinery, to provide tax incentives, and to regulate competition in industries. Hence, the MITI, which also acts as a think tank, was in a unique position to 'maximize induced decision-making' (Evans 48). Similarly,South Korea's developmental state channelled capital, subsidized through foreign loans or low interest rates, to Korea's chaebol and bolstered its own power through political interest groups moulded into a developmental coalition. However, such financial structure was intrinsically unstable for several reasons.

First, the interest subsidy created an incentive for firms to borrow heavily instead of tapping the public markets. The high leverage meant that bankruptcy was a constant threat and firms were vulnerable to fluctuations in earnings. Banks often ended up carrying a large amount of non-performing loans; if these were incurred by conglomerate firms, the state often had to bail them out, in effect creating a moral hazard—an accountability deficit—for the firms. Second, because in this system, any institution large enough to be a significant factor in the community can turn to the state for a bailout, it is in the interest of the firms to expand in size, to empire-build so that the possibility of bankruptcy would pose a social threat. Third, the Korean economy, even more so than the Japanese, relies exceedingly on export; hence excessive investment in export industries increases its vulnerability to exogenous shocks. Thus, state interventionism in the market is a double-edged sword. While the developmental state can achieve its goals by manipulating the financial structure, it also socializes risk, either through inflationary refinancing (monetary means) of nonperforming loans to bail the firms out, or through increase of the state equity share of the banks (fiscal means). (Woo-Cummings 26-27)

In East Asia, the developmental state's bureaucracy has several important characteristics. Profits and investment depend on decisions made in the state. There is extensive discourse on 'developmentalism,' the necessity of industrialisation and of state intervention to promote it. Furthermore—and this is where East Asia diverges from Latin America—the bureaucracy is a powerful social group of bureaucrats with predictable and coherent interests (28). In Japan, the small, elite state bureaucracy is recruited from the top ranks of the best law schools; appointment is made based on national examinations and is unaffected by election results. "The bureaucracy drafts virtually all laws, ordinances, orders, regulations, and licenses that govern society. It also has extra-legal powers of 'administrative guidance' and is comparatively unrestrained in any way…by the judicial system" (28). The responsibilities of this bureaucracy are to devise broad industrial policy and the means to implement it, and ensure highly regulated competition in selected sectors. According to Woo-Cummings, Johnson makes a crucial insight that the successful development state is one that knows when to quit, as the task of the development state in Japan (or South Korea or Taiwan) is a deliberate transition from a producer-oriented, high-growth economy to a consumer-oriented one, which may mean the state's own declining significance. Thus, the public-private cooperation between the bureaucracy and business is one that has been developed and refined through institutional adaptation over time and responds flexibly to changing new realities (28-29).

In his book Embedded Autonomy, Peter Evans invokes this amalgam to describe the developmental state in Northeast Asia. 'Embedded autonomy' combines Weberian bureaucratic insulation with a tight connection to the surrounding social structure. The state's autonomy is embedded in a concrete set of social ties that bind the state intimately to society and to particular social groups, providing institutionalised channels for the continual joint adjustment and transformation of goals and policies (Evans 59). In Japan, the highly selective recruitment of civil servants and long-term meritocratic rewards create commitment and a sense of corporate coherence. As such, the behaviour of bureaucrats is bound to the pursuit of collective goals rather than individual opportunities presented by the market, allowing the state to act with autonomy from certain societal pressures. The developmental state's informal networks, both internal and external, further enhance coherence of the bureaucracy. Internal networks refer to the ties among classmates at the elite universities from which officials are recruited, fundamentally dependent upon the strict selection process. The fact that formal competence, as opposed to clientelistic ties or loyalties, is the chief requirement for entry into the network makes it all the more valued among loyal members. More significantly, on the external front, the administrative web is woven extensively into Japanese society, as industrial policy relies on the relationship between ministries and industrialists. Ties between bureaucracy and private corporations are reinforced by the role of MITI alumni, who often end up in crucial positions in corporations, industry associations and quasi-governmental organizations. Given a sufficiently coherent, cohesive state apparatus, connectedness thus serves to increase state competence instead of capture (50).

The common thread in both Johnson's conception of the developmental state and Evans' embedded autonomy pertains to the state's role as a partner with the private sector in the national industrial transformation. The state is a catalytic agency and managers respond to the incentives and disincentives the state establishes. This is not to say that such a framework is not flawed. An oft-cited criticism, especially during the throes of the Asian Financial Crisis in 1997, has been that the Japanese and Korean structures have resulted in rampant corruption, as industrial policy has also been commonly used to promote vested interests over national development. The developmental state is in effect a paradise for big business. The oligopolistic nature of the keiretsu or chaebol means that private power and domains are immense: in Korea, the chaebol take on quasi-state importance and often have 'company towns' that employ, house, feed, educate, and provide credit to millions of Koreans (Woo-Cummings 31). The combination of lack of transparency, close ties between the state, banks, political parties and firms, government-directed lending, high corporate debt-to-equity ratios, and national industrial policies toward establishing globally competitive sectors, may be vulnerable to moral hazards that foster corruption and irresponsible corporate investments. During the Asian Crisis, critics therefore conveniently drew upon these attributes of the developmental state model, particularly that of South Korea, and blamed 'crony capitalism,' 'bad governance,' and government interference as causal factors for the regional meltdown. This view, however, ignored the fact that the Asian development model had existed for decades prior to the crisis, during which the region had experienced spectacular economic growth that lifted 400 million people out of poverty through hard work, the establishment of competitive niche markets internationally, and high household savings that were reinvested into the domestic economy. (Hall 73, 86-87)

The Japanese developmental state model has been emulated, in varying degrees, by South Korea, as cited above, Taiwan, Singapore, and Hong Kong. As discussed above, while Korea demonstrates the importance of bureaucratic traditions, it also reveals the vulnerability of bureaucracy. Rhee Syngman's regime was more predatory than developmental: civil servants were mostly 'specially appointed,' bypassing the examination process that was so critical in selecting high-quality recruits; Rhee's dependence on private-sector donations to support his political dominance resulted in rampant rent-seeking. It was not until Park Chung Hee ascended to power that the Weberian bureaucracy was revitalized. The junior officers involved in the coup were united by strong reformist ideological convictions and close interpersonal ties based on service experience. Similar to the MITI, Korea's Economic Planning Board (EPB), became a 'superagency' to give coherence in the economic arena. Diverging from the Japanese prototype, the Park regime aimed for dominance over private capital. The ties between the regime and the largest conglomerate business groups became so tight that the term 'Korea Inc.' was dubbed by economists. Such embeddedness was much more 'top down' than the Japanese model, lacking Japan's well-developed intermediary associations and focused on a small number of very large firms. The Korean state does not have the same generalized institutional relation with the private sector the MITI system had; therefore it never fully avoided the risk that the particularistic interests of individual firms might lead to unproductive rent-seeking (Evans 52-53).

Diverging to the opposite direction from the Japanese model is Taiwan. Like Japan and Korea, the Taiwanese state has been just as crucial in industrial accumulation, channelling capital into transformative investments, inducing entrepreneurship, and bolstering the competitiveness of firms in the global markets. The legitimacy of the state also depends on a Weberian bureaucracy that is meritocratically recruited and reinforced by ties to external organizations. Taiwan's differences stemmed from its historical experience: after arriving on the island, the Kuomintang (KMT) regime was determined to free itself from its rent-seeking past on the mainland. It put together a set of elite economic policy organizations similar to the MITI and EPB. The experience of being undermined by the particularistic interests of private speculators has instilled a fundamental distrust of private capital. The KMT opted for state-owned enterprises (SOEs) as instruments of industrial development, especially in basic and intermediary industries. The state enterprise sector also serves as a training ground for economic leadership in the central bureaucracy, keeping the private sector largely out of economic policy networks. Informal public-private networks are less dense than the Korean and Japanese versions of the developmental state, but are still significant to Taiwan's industrial policy. An example is the textile 'entrustment scheme' in the 1950s: by providing an assured market and raw materials, the state stimulated private investment and minimized entrepreneurial risk involved in entering the textile industry. The KMT regime gradually exposed its 'greenhouse capitalists' to the market, making export quotas dependent on the quality and price of goods and diminishing protection over time. Importantly, the Taiwanese state is highly selective in its interventions, preferring to conserve its bureaucratic power rather than overextend the state apparatus. (Evans 54-58)

In the 1970s, Singapore developed its economic bureaucracy to revise investment incentives, in order to lure new investment away from labour-intensive sectors and toward higher value-added ones. Singapore's bureaucracy began to exercise extensive control over prices of factors of production: the government provided land, invested heavily in human resources development, and supplied funds for technological R&D. Through incentives, the state can induce TNCs to invest in higher value-added operations and generate high-wage jobs. The Ministry of Trade and Industry (MTI) is responsible for soliciting foreign investment, directing this investment into strategic sectors, and maintaining ties with international business clientele. State enterprises are required by law to break even and are subject to fiscal and monetary restraints. The autonomous Monetary Authority of Singapore (MAS) is in charge of regulating the financial sector and holds monetary stability as its top priority. The incumbent government elite has had a successful track record in dealing with external economic fluctuations and possesses an institutional capacity for long-term bargaining with all the major sectors of society. During an economic downturn, economic officials can obtain the cooperation of these sectors with tightening policies, which allows Singapore to manage its national economy effectively in light of global economic changes. (Chu 668-670)

Hong Kong's economic bureaucracy is centred on the principle of 'positive non-intervention.' It has no planning agency or central bank, and the government has maintained an arm's-length relationship with the private sectors. Transnational banks, which dominate the financial sector, are mostly self-regulated and help shape the liberal regulatory environment conducive to their offshore banking operation (Chu 661). Even after the 1997 reunification with China, under the 'One-Party Two Systems,' the local government in Hong Kong has maintained its efficiency and a relatively corruption-free bureaucracy to administer public policy, with an industrial adjustment policy characterised by minimal intervention and reliance on market mechanisms. Despite Hong Kong's 'marketeer' approach, the government does intervene in the market under special circumstances, as it did during the Asian Financial Crisis. When hedge fund speculators made a 'double play' by shorting both the Hong Kong currency and stock market, the government responded by restricting various forms of trading on the stock market to ease pressure on the currency. In an unusual step, it bought up 6% of the stock market, acquiring a national stake in the sector at the cost of 15% of its foreign reserves in as little as two weeks. The government thus succeeded in warding off the speculative attacks by keeping the price of stocks high. The Chinese government was kept well-informed about the Hong Kong government's interventions, and even provided ample funds to protect the Hong Kong dollar (Wade and Veneroso 23-24).

In East Asia, patterns of state-society relations are fundamentally different from those in the West. East Asian states pervade into society; as a result, the lines between public and private, government and market, are often blurred. The concept of the 'developmental state' means that government and private industry are in a mutually beneficial relationship, so that neither state nor enterprise prevails over the other. The state establishes incentives and disincentives to direct private investment; the success of enterprise in turn reinforces state legitimacy. According to Johnson, the source of authority in the developmental state is one of 'revolutionary authority': the authority of a people committed to the transformation of their social, political, or economic order. Hence, legitimation stems from the state's achievements, not the way the state came to power. Such attributes of the developmental state model have contributed significantly to the highly successful economic development in Japan and the NICs seen in the recent decades.

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*Date written: 2007*