14. When wars of attrition end, the settlement necessarily produces a new state. The Irish Republic in the UK; the Bangsamoro Authority in Mindanao in The Philippines; Chechnya in the Russian Federation; Bangladesh and the Turkish Cypriot Republic; Eritrea in Ethiopia; the Palestine Authority in the West Bank and Gaza; the Republika Srpska in Bosnia Herzegovina. The international community's dedication to world peace has been unable to produce any other way forward. The dream of a return to the **status quo ante bellum** (bolstered by constitutional changes to the state which one party hopes will satisfy the other) is just that - a dream, an unattainable, utopian dream, totally irrelevant to the world of **realpolitik**.

15. A long war of attrition poses a grave danger to the state engaged in it, a danger emanating not from its challenger but from its own armed forces. In both Myanmar and The Sudan, civil government was overthrown by the military in the interests of concentrating **all** the nation's resources on the war effort. So was it also in Ethiopia. This has been the experience of very poor countries which have had to starve the military of funds in order to keep a semblance of civil services going. In such countries, as the military effort escalates, the demand for more and more of the state's limited financial resources for war purposes grows exponentially. When the crunch comes and the state has to choose between starving the military and feeding its people, the decision could well be taken out of its hands by a military overthrow of civil government. Jayasikurui may portend a graver danger to the feeble and already crumbing government of Sri Lanka than to the LTTE.

■

STATE-MARKET RELATIONS IN LATE DEVELOPMENT: THE EAST ASIAN EXPERIENCE

N. Shanmugaratnam

The role of the state in development occupies an important, though highly controversial, position in the scholarship as well as debates in the field of political economy. The 'Keynesian revolution' provided a respectable recipe for state intervention to resuscitate an ailing market economy, stabilize it and accelerate its growth. Keynes was convinced that state intervention was essential for a capitalist economy to weather its inherent cyclical tendency towards crisis. He regarded *laissez-faire* a legend, a bit of metaphysical thinking' (cited in Mattick 1969). In western countries, state intervention acquired even greater importance and legitimacy in the post-war period in order to meet the challenges of reconstruction, regulate the economy and provide the institutional arrangements for administered wages and social security. However, the origins of state intervention to restrict or stimulate market forces and to direct or influence the development process in western countries predate the Keynesian revolution (Polanyi 1957, Gerschenkron 1962). Dirigisme has a longer history than generally acknowledged by the restorationists of the minimal state.[1]

With the birth of a growing number of newly independent countries after World War II, active state intervention in development became an established practice as governments sought to introduce economic planning, nationalization and regulatory policies to 'reconstruct' their national economies. The power of the Soviet bloc and the rise of the 'Chinese model' tipped the balance in favor of a major role for the state in decolonization and development in what came to be known as the Third World. This trend, however, was challenged in the 1970s with the resurgence of the neoclassical theory and ideology of development which 'downgraded' the role of the state (Wade 1990). Today, it would seem that the old Smithian idea of the 'minimal state' has staged a comeback in an updated form. This is also signified by the unprecedented ideological hegemony enjoyed by the Bretton Woods institutions (IMF and World Bank) in the post-cold war era.

The poor economic performance of several newly independent countries in the 1950s and 1960s was attributed by the proponents of the new economic liberalism to undue state intervention in the form of nationalization, subsidies and import substitution. Strictures have also been passed about the abuse of power by political elites as evidenced by corruption, and about the lack of government accountability. State regulation of the economy has also been attacked for encouraging rent seeking which leads to waste of resources. The solution offered is: 'get relative prices right' by withdrawing the state from the economic domain and adopting policies that enable the functioning of freer markets. In theoretical terms, this prescription signified a return to the fundamentals of economic liberalism. This was also reflected in the remarkable 'paradigm shift' in development economies from Keynesian and post-Keynesian macro theories and political economy toward neoclassical economics.

The World Bank and other neo-liberal advocates of the open economy model have cited the economic successes of the East Asian Newly Industrializing Countries (NICs) and Japan as proof of their theory. These claims have been challenged by a growing body of scholarship on the 'East Asian Miracles'. Empirical research and theorization based on it have led to a revival of the classical position of capital accumulation as the engine of growth. This seems to be the political economists' answer to the axiom of efficient resource allocation by free markets as the driving force of economic growth in the NICs. Recent contribution to the debate on state-market relations clearly suggest that heavy state intervention is associated with both development failures and development 'miracles'. Thus, state intervention alone cannot fully explain the failures just as free markets cannot fully explain the successes. The 'statist paradigm' which is emerging from generalizations of the East Asian experience suggests that late-industrialization is state-led rather than market-led until the 'miracle' — or, to put in less mystifying terms, the transformation — is basically accomplished (Amsden 1989, Wade 1990, Appelbaum & Henderson 1992). The term 'developmental state', adopted by several authors writing on the East Asian experience, denotes the interventionist or, to put it more accurately, the directive nature of the state in late industrializing economies. The principal aim of this intervention is to promote capital accumulation, and support and guide private economic activities so as to accelerate industrialization.

The primary objective of this article is to review the role of the state in the economic development of East Asian countries, taking Japan, Taiwan and South Korea as the main cases for the purpose of amplifying the concept of developmental state. This is based on a review of selected literature. It must be pointed out that the aim here is not a detailed historical analysis but a conceptual elaboration based on historical experience. Of course, this is done with due regard to the particularities of the historical contexts of the East Asian cases. This article also comments on the relevance of the model of the East Asian developmental state to other countries in the continent.

Capitalist Developmental State in a Global Typology

The idea of the minimal state conjures the image of a passive, non-interfering state. This, however, is far from the historical realities of state-market relations. Since the classical days of *laissez-faire* to the present, and across the globe where national economies are at various stages of capitalist transition and have taken diverse political economic forms, the state has been an active player in development. However, the role of the state has varied depending on the national historical, the geopolitical and the global contexts. So, it might take upon itself the task of imposing the conditions for free markets to thrive in one instant, and that of regulating and even deliberately distorting markets in another. 'There was nothing natural about *laissez-fare*', wrote Polanyi in his famous book *The Great Transformation*. Tracing the birth of the liberal creed and the institutionalization of *laissez-faire* in 19th century Britain, Polanyi pointed out that 'just as cotton manufactures - the leading free trade industry - were created by the help of protective tariffs, export bounties, and indirect subsidies, *laissez-faire* itself was enforced by the state.... The road to the free market was opened and kept open by an enormous increase in continuous, centrally organized and controlled interventionism'. (Polanyi 1957, p. 140).

This paradox of deliberate state intervention to institutionalize free markets, noted Polanyi, was topped by another when restrictions had to be imposed on *laissez-faire* itself in the same British economy. This new trend of restrictions was the result of collective actions by society demanding state intervention in the interest of social well being. This marked the arrival of the welfare state, and of planning which was unanticipated by the liberal state but which subsequently in the 20th century became an important state activity. The success of trade unionism consigned the idea of a free labor market to history. And to Polanyi the economic historian, *laissez-faire* was a thing of the past. 'In retrospect', he proclaimed, 'our age will be credited with having seen the end of the self-regulating market'. (Polanyi 1957, p. 142). It was as though the era of permanent state intervention in the economy, for socio-political as well as economic reasons, had arrived. Apparently, Polanyi could not anticipate the revival of economic liberalism in the latter part of the 20th century under the tutelage of the Bretton Woods institutions. However, Polanyi's political economic analysis, in which the state is a key actor, enables the anticipation of a more active, planned and continuously interventionist role for the state in a market economy. Unlike the fundamentalist utilitarian who idealized *laissez-faire* as if it should be treated as an end in itself, Polanyi saw the market as a means subject to restrictions and manipulations by the state on behalf of the whole or particular sections of the society, or for the sake of what may be perceived as the national interest. State intervention to govern markets in order to promote capitalist transformation has become a major strategy in the successful late industrialized countries. Japan, Taiwan and South Korea of East Asia stand out as exemplars par excellence. Their historical experiences show that 'governed markets' (Wade 1990) rather than perfectly free markets may be indispensable to promote capital accumulation within a national economy and the latter's industrialization.

It would seem that the later a national economy enters industrialization the greater and more diverse is the intervention of the state. Moreover, the role of the state is quite extensive in all societies where equity and environmental sustainability are major concerns. On the basis of the economic role of the state, Appelbaum & Henderson (1992) have developed a tentative topology of political economies (Fig. 1).

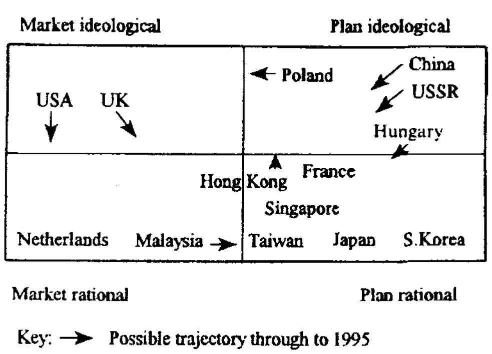

Fig. 1. National Political Economies (1991). *Source:* Appelbaum & Henderson (1992, p. 21).

As shown in the diagram, they locate national political economies in four quadrants representing four different types of macroeconomic rationality in their ideal forms: market ideological, plan ideological, market rational and plan rational. The examples given by the authors (Fig. i) should not necessarily be taken as representatives of the ideal state of the respective types, but rather their assignment to particular slots is indicative of the currently dominant character of public policy and the national economy.

The first two types, market ideological and plan ideological, are highly ideologically motivated while the last two are less dogmatic and more 'pragmatic'. In a market ideological political economy, the function of public policy is to ensure that free markets operate as it is believed that 'the invisible hand' is the most rational and socially beneficent allocator of resources. Though it sounds very classical, this is the policy of the Reaganite-Thatcherite new right or the neo-liberals. In a plan ideological economy, most of the means of production are owned by the state which through a central planning authority takes investment decisions and allocates resources. The commitment to planning is inspired by an ideology of socialism and planning is seen as the best instrument to achieve equity and long-term growth. In a market rational economy, the state plays a regulatory function by providing a framework for investment, production and distributional decisions which remain the preserve of the private sector. A plan rational economy is one in which state regulation is supplemented by state direction of the economy as a whole in accordance with a national vision of economic development and with reference to targets set by macroeconomic planning towards the fulfillment of the vision (Appelbaum & Henderson 1992). Plan rationality implies, among other things, deliberate distortion of markets through such means as subsidies and protectionism with the intent of promoting domestic and international competitiveness and realizing national economic objectives.

While the above typology may be faulted or criticized for not being comprehensive enough to cover all possible types of political economies including populist and regulatory regimes, it certainly is helpful in figuring out an important historical trend as regards state market relations. That is, most if not all the recently successful industrializers are located in and around the plan rational quadrant. In particular, the three East Asian countries that concern us (Japan, Taiwan and South Korea) are located well inside the plan rational quadrant with Korea approximating the ideal type. Even though the state plays developmental roles in a variety of political economies, the term capitalist developmental state is used to denote the state in a plan rational economy. A capitalist developmental state by definition is a 'market friendly' state, but its historical role is to make the market accumulation friendly at home. Its interventions, whether the result is distortion or liberalization of the market, are inspired by this mission. The historical context of late industrialization and the key characteristics of the East Asian developmental state are discussed in the sections that follow.

Historical Context of Late Industrialization

Historically, capitalist development has always been driven by capital accumulation, but the latter's dynamics have become mediated on a growing scale by the state in late industrializing countries (Amsden 1989, Wade 1990, Fukui 1992, Koo & Kim 1992). The basic rationale for active state intervention in late development derives from the need to build up national technological and institutional capacities to be able to compete in a world market dominated by developed economies. Being pitted against technologically superior competitors, the late industrializer cannot rely entirely on the free market to develop productive forces via international technology transfer and to win the battle of competition. The historical context of late industrialization has been eloquently summed up by Amsden:

> If the metaphor of the First Industrial Revolution is 'laissez faire', and that of the Second 'infant industry protection' then that of late industrialization is a category comprehensive enough to overcome the penalties of lateness-call it 'the subsidy'..... To stimulate investment and trade, the state has used the subsidy to get relative prices deliberately wrong-that is, different from what the forces of supply and demand would determine. (Amsden 990, p. 16).

Amsden's periodization of the history of industrialization into there stages or phases illuminates the context of lateness. *Invention* was a hallmark of the first industrial revolution which took place in 18th century Britain while learning and *innovation* distinguished the second industrial revolution which occurred in nineteenth century Western Europe and the United States. Late industrialization, which began in Asia in the second half of the 19th century and continued into the 20th century in Japan and later in its former colonies such as Taiwan and South Korea, has been based almost entirely on *learning* from the earlier industrializers (Amsden 1989)[2] And among the late industrializers the later industrializers tend to emulate their older 'kins' — for example, South Korea and Taiwan adapted the Japanese model. Since industrialization by learning involves the exploitation of the opportunity provided by the existing technological backlog, it requires public and corporate investments in acquiring dynamic national and firm-level capacities to learn, reproduce and manage technology. Whereas some individuals and firms could have initiated path breaking inventive and innovative activities in the past industrial revolutions, a precondition for industrialization by learning is the availability of high-quality human capital on a mass scale. The experience of the East Asian countries suggests that late industrialization entails multiple challenges for the state which are of a different order than simply facilitating free markets through liberalization and provision of essential public goods. In the light of these experiences, the 'harmony' between the state and markets sought by the neo-liberal approach appears to be predetermined by the primacy it accords to 'getting relative prices right' when getting them wrong might be the right way for a national economy to succeed (Amsden 1989, 1990). In other words, some planned distortion of the market may be a necessary condition to promote industrialization and capital accumulation within a national economy and to build up and sustain its future competitiveness. A proposition that emerges is: market friendly should not necessarily mean free-market friendly at all times and in all national contexts. A corollary to this is free markets are not always accumulation friendly if a particularly less-developed nation state, and not the global economy as a whole, is our unit of concern.

Two crucial external factors should not be lost sight of in the global contextualization of late industrialization, particularly after World War II. These are the geopolitics of international technology transfer and development aid and the global economic trends. With the arrival of bipolarism and the Cold War, countries in the Third World that joined the anti-communist, pro-West camp were in a favorable position to receive western and, since the 1960s, Japanese support. Although this was not a sufficient condition to initiate industrialization at the national level, it turned out to be a necessary condition to obtain favorable terms of technology transfer, development aid and export quotas as shown by the experiences of Taiwan and South Korea. Both these countries were under the direct occupation of Japan until World War II. After the war, while South Korea came under US occupation, Taiwan became a close client of the US as an anti-Communist outpost. Yet both Taiwan and South Korea gained a lot in term of technology transfer from both powers. Since the mid-1960s, they turned more towards Japan for technology transfer (Amsden 1989, Wad 1990). The threat to South Korea from the North and to Taiwan from the mainland did play a major role in motivating the ruling blocs in these countries to transform their economies and also be concerned about income distribution and social welfare.

Concerning the second external factor, global economic trends, the rapid industrialization of South Korea and Taiwan and the spectacular revival and rise of the Japanese economy were fuelled by the rapidly expanding world economy in the post-war period. However, these external factors provided only the opportunities for technology transfer and late industrialization to national states allied to the capitalist imperialist powers. As to how far they were exploited dependent on the internal capacities of a particular country. For instance, the Philippines was also a favoured client of the US but it failed to become a late industrializer. Why and how did South Korea and Taiwan succeed where the Philippines failed? This is where the developmental role of the state becomes one of the vital explanatory variables.

The Key Features of the East Asian Developmental State and Aspects of Economic Policy

> Behind the economic performance of the Asian tigers breathes the dragon of the developmental state. (Castells 1992, p. 55)

The idea of the East Asian developmental state is common to several authors although there are variations in description and conceptualization (See Johnson 1982, White 1988, Amsden 1989, 1990, Wade 1990, Appelbaum & Henderson 1992). One element that is integral to the general notion of the developmental state is the directive role of the state in economic development. There are also authors who do not explicitly adopt the term developmental state but admit the leading role of the state in East Asian economic transformation, for example Shinohara (1982) and Rosovsky (1972) on Japan. The unprecedented directive role of the state in a capitalist economy was succinctly put by a vice-minister of Japan's Ministry of International Trade and Industry (MITI):

> The MITI decided to establish in Japan industries which require intensive employment of capital and technology, industries that in consideration of comparative cost of production should be the most inappropriate for Japan,industries such as steel, oil refining industrial machinery of all sorts and electronics..... But, from a long-range view-point, these are precisely the industries where income elasticity of demand is high, technological progress is rapid, and labour productivity rises fast. (OECE 192, p. 15)

Some generalizations may be made on the basis of the experiences of East Asian economic development. Above all the other institutional needs to overcome the penalties of lateness, stands the need for a developmental state capable of seizing the moment for industrialization in the cycles of expanding and shrinking opportunities of the world economy. The overriding motto of the developmental state is to promote and guide expanded reproduction of capital within the national boundaries. Liberalization and institutional choice are subordinated to this national goal. Whereas the neo-liberal paradigm is underpinned by an abstract economic internationalism, the ideology of the developmental state is an economic nationalism which is not xenophobic but opportunistic in that it is meant to promote accumulation within the national economy through carefully planned import substitution and export promotion strategies. A developmental state presupposes the capture of political power by an elite representing the interests of industrial capital and imbued with a vision of national capitalist transformation.[3]

The most distinguishing characteristics of the East Asian developmental state are:

(i) The autonomy to devise long-term economic policies without interference from private interests (Wade 1990, Koo & Kim 1992);

(ii) the capacity to exercise a large measure of control over the behavior of domestic and foreign capital (ibid);

(iii) high priority to technology transfer and development and human capital formation;

(iv) the capacity to repress labour and mass movements for democracy on the one hand, and paternalistically to intervene in order to obtain real wage increases for workers, as productivity per worker rises, on the other,[4] and

(v) an ideology of legitimation resting on the state's ability to promote high rates of economic growth and structural change

(Castells 1992), economic nationalism, and on paternalism in employer-employee and state-people relations.

The autonomy of the state is not class neutral but it implies the subordination of the private interests of individual capitalists to the general goal of national capitalist transformation. The developmental state provides the infrastructural and institutional environments and economic incentives to enable industrial capital to gain the upper hand over commercial (merchant) and financial capital. It introduces land and agrarian reforms to stabilize the countryside politically by eliminating or reforming power structures that obstruct the growth of productivity and industrial capital.[5] A central aim of development policy is to increase productivity in both agriculture and the secondary sectors. The Five Year Plan, which is a common feature of late industrialization, serves as a tool for the government to gain an overview of the national economy and to identify the high potential industries and modalities of public intervention for economic diversification. The governments of Japan, South Korea and Taiwan established elaborate institutions staffed by highly trained personnel to deal with macroeconomic policies, planning and monitoring. Industrial policies and planning in these countries were guided by a futuristic analysis of comparative advantage and global competitiveness. Such policies have little in common with the static theory of comparative advantage based on the current status of a country's resource endowments and technical efficiency and on free trade.

In practice, the state actively facilitates the formation of a domestic-industrial-capitalist class by advancing capital to investors as long term loans at subsidized interest rates and by providing other incentives. The latter include protection of domestic industries from foreign competition, import tariff exemption on capital goods, and extra subsidies to exporters in the form of expot-effective exchange rates. Informed by its futuristic economic plans, the state guides the flow of investment into industries selected by its technocracy while punishing and disciplining those capitalist clients who fail to show expected results. While saving is encouraged by granting attractive rates of interest, bank interest rates on capital are determined according to investment priorities worked out by the policy and planning authorities. This was made easier in the East Asian countries as the state controlled a major part, if not the whole, of the banking system. Capital credit, therefore, was not in general allocated by the free market as dictated by the forces of demand and supply. Interest on capital borrowed from the banking system remained below the market rate for high-priority investments. The underlying rationale for making credit cheaper is that it can help increase international competitiveness. The alternative source to borrow from is the curb market, where interest rates are much higher, which makes the official source more preferable to potential investors. Institutionally and in formal and informal ways, there is an interpenetration of finance and industrial policies (Amsden 1989, Wade 1990, Koo & Kim 1992, Amsden & Euh 1994).

A notable tendency among late developers is the growth of oligopolies which account for a relatively large share of the national product. Industrial policies in the East Asian countries have encouraged mergers of firms in key sectors. In Japan, where this policy was first put into practice in East Asia, MITI provided the rationale for conglomeration in terms of 'bigness' facilitating international competitiveness and reducing excessive national competition (Okhawa & Kohoma 1989). The same policy was adopted in Korea and Taiwan too. There has been some controversy over the economic rationale of bigness (achieved through concentration and centralization of capital), which derives from economies of scale and scope. Critics have cited the failure of American giant corporations to best their foreign competitors (Japanese, Korean and Taiwanese firms among them) as evidence of inefficiency of the former. Reviewing the debate, Amsden (1989) argues that:

> America's corporate giants may not have performed well over the last fifteen years, and they have certainly lost markets to Japan and to late-industrializing countries like Korea. Yet the economies of Japan and late-industrializing countries are also dominated by corporate giants. Economies of scope, moreover, may benefit one firm at the cost of another, but society at large can still benefit if size improves the international competitiveness of the aggrandizer. The point, therefore, is that nothing can be said *a priori* about the effect of bigness on performance. Instead, how well big business performs depends on how well it is coordinated and the context on which it functions. (p. 118)

Apart from subsidies and protectionism aimed at raising private profitability (or off-setting private losses) in selected production activities, the growth of industrial capital was also facilitated in East Asia by creating and enforcing legislation to suppress speculative domestic and overseas investment. For instance, rent-seeking and speculation were widespread in the 1960s in South Korea. Speculation in urban real estate was considered serious enough by the Park regime to introduce legislation to control it (Koo & Kim 1992). When interest on official loans is lower than the free market rate[6] the temptation among the recipients of such loans to engage in money-lending in the curb market can be expected to be high. However, in a developmental state subsidized credit is granted only to firms selected by the government as capable of showing satisfactory results. Moreover, the state takes tough measures to ensure that the borrower utilizes the loan fully and efficiently for the purpose it was granted. The measures include performance standards in terms of productivity, quality and rates of growth. Those who fail to show satisfactory results are disqualified from receiving further subsidized credit. As noted by Amsden (1989), the subsidization process in successful late industrialization is reciprocal in that the government extracts higher growth rates in return for subsidies. This is quite different from the unidirectional flow of subsidies to firms from the state which has no capacity to discipline the former —a common situation in many developing countries. The East Asian developmental states, while being repressive of labour, insisted on high performance from firms.

The conflicts between financial (banking), commercial and industrial capitals may also be partly resolved by their merger in the hands of big business; as for example, in the conglomerates like zaibatsu and chaebol in Japan and Korea respectively. Speculation in agricultural land was controlled by suppressing land markets through strictly enforced ownership ceilings after implementing distributive land reforms in Japan, Korea and Taiwan. In all these countries, the aim of land reforms was not to create free land markets but to eliminate landlordism and the rural power structures that were not conducive to the growth of industrial capital. The reforms paved the way for consolidating a rural petty bourgeoisie and for a rapid Green revolution. The prevention of free trade in agricultural land and the stabilization of the small family farm as the basic unit of production served as incentives for land improvement and intensification (Amsden 1989, Wade 1990, Appelbaum & Henderson 1992).

In these and other ways, Japan and the NICs often disregarded the virtues of liberalization enshrined in the economic dogma. For them import substitution and subsidizing exports had greater practical relevance than liberalization in their earlier (and even subsequent) phases of industrialization. Industries established under such policies in East Asian countries were all protected until the domestic firms became sufficiently competitive to face foreign firms on their own. This protectionism went beyond the norms of infant industry protection in terms of choice of the industries, and the scale and number of years of protection (Shinohara 1982). As noted by Shinohara (1982):

> Import restriction and postponement of capital liberalization provided a preparatory period in which firms could strengthen their competitive position through technological advance and other means. By the time the first steps were taken for capital liberalization, Japanese corporations had become strong enough; it was of little concern to them. (p.50).

Japan's powerful MITI consistently adopted two basic criteria to design dynamic intertemporal industrial policies aimed at building up future comparative advantages. The 'income elasticity criterion' was used to identify the industries with comparatively high elasticity of export demand with respect to world income as a whole.[8] The 'comparative technical progress criterion' was used to study 'the possibility of placing a particular industry in a more advantageous position in the future through a comparatively greater degree of technical progress, even if the cost of the product is relatively high at this stage'. (Shinohara 1982, p. 25).

In Japan, these dynamic considerations of competitiveness invariably made it necessary to choose certain capital-intensive industries even when labour supply was 'unlimited'. However, capital intensive industries were not attractive to the private sector as their profitability in the early phases was lower than that of labour-intensive ventures. The state stepped in as a direct investor in heavy industries and with subsidies and protectionist policies to attract the private sector. Heavy industry enterprises like steel and petrochemicals were state owned to begin with and remained so for several years before they were privatized. The same approach was adopted by South Korea and Taiwan (Amsden 1989, Wade 1990). In fact, the stories of the steel industries of Japan and South Korea are not only similar but show how the latter learnt from the former and excelled in steel production which it embarked upon against the advice of the World Bank.[9] The Nippon Steel Company of Japan was established as a state enterprise in the 1950s and nurtured under protectionist policies until it was set to become the world's leading steel producer in the 1970s. Taking the Japanese company as the model, the South Korean government created in 1968 the Pohang Iron and Steel Company (POSCO) with Japanese technical assistance. POSCO enjoyed several forms of subsidies which covered investments in infrastructure (roads, harbour and electricity) and long-term low interest foreign capital to purchase equipment. Through intensive learning and efficient management POSCO became one of the lowest cost steel-makes in the world (Amsden 1989).[10]

The future-oriented export policies were accompanied by judicious practices of import substitution and active adoption of foreign technologies. The two were linked to a common strategy of strengthening firms' competitive advantage through higher productive efficiency. The economic histories of Japan, South Korea and Taiwan show that the different phases of industrialization were shortened by deliberate policy actions in order to move forward faster. Referring to this as the 'telescoping process', Okhawa & Kohoma (1989) have shown that while Japan took 34 years (1885-191) to complete the 'Traditional product export and primary import substitution phase', Taiwan and South Korea were able to telescope it into 20 (1950-1970) and 19 (1953-1972) years respectively. They also show that whereas it took 40 years (1919-1960) for Japan to complete the phase of 'Secondary import substitution', Taiwan and South Korea had the capacity to accomplish it in just 15-20 years. Agricultural intensification in these two countries was telescoped as well (Okhawa & Kohoma 1989). It may be generalized that this telescoping of development phases is a historical necessity imposed on late industrializers by the imperatives of catching up and moving ahead in a world of competition and uncertainties. These imperatives are part of the driving forces behind the macro rationality for economic planning and state intervention.

A crucial aspect of raising competitiveness is the combination of high productivity with relatively low wages; the latter being made possible by the availability of a large supply of literate and skilled labour, i.e. developed human capital. However, raising technological capability is the key to sustaining competitiveness in the long-run, as the comparative advantage due to low wages would begin to disappear as real wages rise and as more LDCs succeed in getting onto the road to 'NICdom'. Human capital formation involves a host of externalities and many of them do not lend themselves to market solutions (Stewart & Ghani 1992). In more recent times, the World Bank itself has admitted that public investment in primary and secondary education is necessary for human capital development although it is not in favor of subsidies for higher education (World Bank 1991). Both the public and private sectors have played active roles in the development of human capital and national science and technology infrastructures in Japan and the NICs. The state invested in formal education to create a high national literacy rate. The state and private sectors invested in institutions of higher education and technical training to raise the supply of scientists, engineers, junior technicians and vocationally trained people. A third and vital form of investment in human capital development took place at firm level in these countries. This can be called investment in learning and mastering particular imported technologies. In their early phases of industrialization, Japan, South Korea and Taiwan sent large num bers of young technologists and even skilled workers to the industrially advanced countries in the West for further training. 'Learning by doing' and training at higher levels at the firm's expense are investments which generate real externalities as the skills learnt by an employee are personalized and would be lost to the firm if he or she chooses to leave, say for a higher wage in another firm. Moreover, leakage of newly produced technological and managerial information from original sources to other competitors cannot be totally prevented. Inter-firm mobility of skilled workers and technologists can be expected to be high in a liberalized labour market. When such labour mobility is confined to the national labour market, it promotes technological diffusion within the nation (Stewart & Ghani 1992).

On the other hand, the inability of a firm to internalize the technological externalities to its competitive advantage could turn out to be a disincentive to the firm when it comes to longterm investments in R&D and personnel development. This disincentive has been countered in the East Asian countries by state interventions to provide one or more of the following: subsidies for R&D; tax relief, financing the coordination among, and joint research by, firms to promote technology-intensive and high priority industries; and temporary protection of industries during their phase of high externalities (Amsden 1989, Wade 1990, Stewart & Ghani 1992).[11] There is another crucial factor pushing firms to invest in increasing their technological capability. As already mentioned, the comparative advantage to a NIC due to low-wage is a temporary factor. With rising productivity, real wages have increased impressively in the East Asian NICs. As more countries qualify to NIC-hood, the older NICs would face competition from new sources. Being aware of this, the older NICs had no option but to opt for technological-capacity building as a means to raise long-term productivity. 'When the government began sweetening the incentives to investment in R&D', writes Amsden (1990) about South Korea, 'big business began responding like clockwork to form centralized research laboratories' (p. 31).

New Challenges for the Developmental State

The developmental state is a dynamic institution leading the transition towards an industrial society in the era of globalization of capital. Its historical role is that of a strategist and actor in the transformation of a pre-or non-industrial economy into an industrial one. In East Asia, its style had been top-down and authoritarian. At the same time, the relative stability of the authoritarian East Asian states was dependent not only on coercive means but also on a wide social base whose support was enlisted through impressive national economic performance, real wage increases and welfare improvements, and ideological propaganda.[12] However, as the industrial capitalist class, whose formation and growth the state facilitated, gains strength and as new alliances between domestic firms and banks and international capital become consolidated, the balance of power between the state and big business undergoes changes. Furthermore, as a NIC takes-off into high growth rates, external pressures on it to further liberalize trade keep mounting. Big firms would not want totally to lose state patronage but would certainly want more freedom in business decision-making and operations. The unprecedented overall growth in education, waged employment and mass communication provides the objective and subjective conditions for the workers and professionals to step-up their demands for better employment contracts, democratic freedoms and social security. In fact, the movement for democracy has taken on a mass character in South Korea, with blue- and whitecollar workers joining the campaign while university students play the most militant role.

These trends imply that the political environment is changing rapidly with the consequence of a crisis in legitimacy for the developmental state. The experiences of recent and previous democracy movements in South Korea suggest that the political challenge to the authoritarian developmental state can take popular and militant forms. Sustained mass protests indicate that the old top-down approach cannot work as it did in the past and that the state's role has to be redefined if the system is to avoid a political crisis. Developmental statism tends to intrude extensively into civil society which people's movements seek to reclaim. In such circumstances, the reconstitution of legitimacy involves, among other things, the institutionalization of political pluralism, mediation between employers and employees within a more democratic framework, provision of social security and, sooner or later, measures to protect the environment. The economic role changes too as the government has to deal with external partners like the US and the EU (and individual industrial countries) who might have once played patrons but now demand freer trade relations or re-negotiation of old bilateral trade agreements and practices. At this stage, the developmental state may begin to be an obstacle to further economic change and a source of instability, if it is not reformed to accommodate popular demands and to be more innovative in dealing with national and international economic problems.

The emergence of these challenges may make it necessary for the state to play a more diversified role and also decentralize itself. The economic role may acquire a wider character when political liberalization and social security are brought upfront on the agenda for change; for instance: pursuing national economic interests more actively through strengthening regional blocs like the ASEAN to more effectively deal with the US, EU and other partners and competitors, enforcement of employees' rights at workplaces and of environmental standards, and to mobilize surpluses for the implementation of social security policies. State regulation of the economy has become a common feature in the West after World War II due to what Hirsch (1977) has called the 'distributional compulsion', which requires resources for collective provisioning. However, the welfare state is under attack in the West by the neo-liberal wave of privatization and elimination of subsidies. In such a global context, will the government of a successful late-industrializer choose the path of welfare statism ? Our tentative answer is: it depends on the balance of political forces in the country.

Relevance to Other Developing Countries

> The need to intervene is greater than in the past because the curses of backwardness are greater. (Amsden 1989, p.55)

In this section, we limit ourselves to some general remarks and to Asia. To assume that the East Asian developmental state can be made into a model which has universal validity would be to make the same mistake as the neo-liberals who prescribe the same policy set to all developing countries. However, the experiences of the East Asian countries offer some basic lessons which compel other countries that are striving to industrialize themselves to question the universal validity of the neo-liberal prescriptions of the Bretton Woods institutions. A major lesson in this regard, generally relevant to all developing countries, is the recognition of the historical context of late industrialization with reference to the role of the state in directing the capitalist transformation of the national economy. The reader is referred to our earlier discussion based on Amsden's contextualization of industrialization by learning. It must be emphasized that agrarian reforms, aimed at removing obstacles to farm level capitalization through intensification and to the sustained rise of industrial capital, constitute an essential first step in late industrialization.

A necessary condition for rapid industrialization would seem to be the creation of the institutional framework for a plan rational political economy. This proposition leads to a serious contradiction with the neo-liberal interpretation of 'market friendliness'. To the World Bank and IMF, market friendly means free market friendly and state intervention implies correction of Pareto-relevant market failures to enable freer markets to flourish and the provision of public goods. The history of the East Asian countries shows that the state has to take on a much more directly interventionist role to enable the formation of a domestic industrial bourgeoisie and the achievement of longterm international competitiveness. And the state strives to manipulate markets, wherever necessary, to make them serve investment, accumulation and reinvestment at home. Such market distortion is a part of a larger structure of incentives and constraints created by the state to sustain an investment-friendly environment within its national territory. Based on a thorough and original study of Taiwan's industrialization and a review of the other Eat Asian countries, Wade (1990) explains the reason for such a role for the state:

> ... as capital becomes internationally mobile, its owners and managers have less interest in making long-term investments in any specific national economy, and hence less interest in the overall development of any specific economy including their home base. As wages rise, they may be inclined to relocate their assets abroad, or divert them into short-term speculative uses at home, or use their influence over state power to keep labour costs lower than otherwise. From the perspective of a national interest, however, they should be encouraged or cajoled to reinvest at home, and specifically to invest in technological improvements as a way of remaining internationally competitive despite higher wages. (p. 351)

Indeed, Wade's conclusions underline one of the most important characteristics of the international environment in which a country has to choose its national industrialization strategy, i.e. the accelerated mobility of capital across national boundaries. A developing country that has adopted full-scale liberalization is forced to adjust and readjust to signals from the world economy which are essentially short-term (Wade 1990). This is not conducive to planning and promoting long-term industrial development. The macro political economic challenges of national capitalist transformation in the era of globalization of capital would seem to render the neo-classical axiom of microeconomic rationality based on the fiction of perfect competition irrelevant as a guide to national policy-making. The question then arises, why then is this great push for liberalization by the Bretton Woods institution when empirical evidence is overwhelmingly in favor of plan rational political economies? We shall not pursue this question in any detail here. It must, however, be said that the ideological proclivities of these institutions have serious consequences in many nation states in the South that are highly dependent on them for development loans and aid. To those who believe in excessively value-loaded assertions such as that Japan would have developed even faster if not for the MITI or that South Korea achieved success despite state interventions,[13] Wade (1990) provides the answer:

> It is less plausible to say that the three countries with arguably the best development performance would have had still better performance had their governments intervened less, than to say that interventions made with the clear intention of accelerating development and formulated by a coherent organization did indeed have the intended effect. Those who deny this are claiming extraordinary ability to forecast historically unprecedented performance. (p.343)

While the case for a plan rational approach to late industrialization is evident, the prospects of its operationalization in a given less developed country would depend on a host of national and international factors. Nationally, the nature of the political leadership in terms of its development vision and its capacity to create the institutional environments to enable capital accumulation through agricultural and industrial development are important. Internationally, a country must have access to technology and markets on favorable terms. The current global economic situation does not seem to be as favorable for late industrialization as in the three decades after the war. The world economy has largely been afflicted by recessions in the past decade. However, the regional variations should not be missed. In particular, economies in East and Southeast Asia have been continuously expanding at impressive rates. This provides the less developed countries in Asia-including South Asia - an opportunity to benefit from the extended growth impulses from the expanding economies of the region and by tapping the possibilities of technology transfer from their more advanced neighbors. China and Vietnam have joined the race toward NIC status while Malaysia, Thailand and Indonesia are surging ahead.

The case of China seems instructive though by no means typical. Its impressive growth rates cannot satisfactorily be explained in neoliberal terms (Bowles & Dong 1994). Indeed, China adopted a cautious open economy policy learning from the experiences of its successful capitalist neighbors and former ideological enemies-Japan, Taiwan and South Korea. It seems that it is steadily making the transition from a plan ideological to a plan rational economy in which market forces are governed. After the revolution, the ruling

Communist Party introduced radical land reforms and developed China's infrastructure and human resources. The state provided free education to the population and raised the quality of the human capital. It created a national science and technology base and a technocracy. All these seem to have stood China in good stead to make the transition — unanticipated by the Maoist leadership — toward a capitalist developmental state. It is worth remembering that even though the share of the state sector in China's total industrial output is declining over the years due to privatization, it still remains high. So is the share of the collective sector. In 1992, the state and collective sectors' shares were 48% and 38% respectively (Bowles & Dong 1994). The Bretton Woods institution will, of course, press China to accelerate its pace of privatization. The point, however, is that with limited privatization and careful opening up of the economy, China has made the most impressive achievements in industrialization for any developing country. One may be easily tempted to buy the story that China's slow pace of privatization is the result of an enduring influence of the old socialist ideology. Of course, the influence of this factor can be significant, particularly the fact that the popular socialist ideology rejected private ownership of the means of production as anti-social and provided legitimacy to public and collective ownership. Over the past decade, the Chinese Communist Party has been systematically developing an alternative ideology to legitimize privatization. It would seem that this is going on in conjunction with the process of privatization which is actually governed by the imperatives of the transition toward a plan rational political economy. An important factor related to this is that the Chinese political leadership is aware of the transaction costs of privatization in an economy in which the means of production have been almost entirely owned by the state and the collective sectors. Pei (1994) points out that the transaction costs of privatizing or redefining the property rights of China's massive public enterprises to facilitate marketization are too high to make the switch at the present stage. Pei argues that by comparison the transaction costs of defining property rights in the Township and Village Enterprises (TVEs) have been low and affordable. Using the transaction costs argument as the key to understanding the problem of privatization, Pei goes further to assert that the Chinese state is not as interventionist as believed by the analysts who see it as a developmental state. The debate on the role of the Chinese state in the ongoing capitalist transition is still as an incipient stage. No doubt, China will continue to be watched with great interest by development researchers, not to mention other countries and international development agencies, because of its regional and global importance and the internal peculiarities of its transition toward an industrial society.

In South Asia, India and Sri Lanka seem to offer other interesting scenarios. Unlike their East Asian counterparts, these two countries have a democratic political framework and a multiparty system with a longer tradition, although as to how democratic they are is debatable. Both these countries are multiethnic and have internal conflicts the types of which did not exist in the three East Asian countries reviewed in this article. They have also implemented stabilization and liberalization including privatization programmes to varying degrees. Sri Lanka adopted an open economy policy in 1977 and became a highly dependent client of the Bretton Woods institutions. Its overall economic performance in the post-stabilization period has been modest in terms of growth rates and mixed and unimpressive in regard to balance of payment reduction while the society has experienced declines in social welfare (Taylor 1991). Productivity in agriculture has been stagnant or declining while it remained low in manufacturing.[14] This means that there has not been any sustained and effective policy interventions to promote productivity growth in the past 17 years. The country's ethnic conflict became militarized after 1977 with serious consequences to political stability and the economy. The post-1977 years also saw an unprecedented erosion of democratic rights. The state lacked the necessary autonomy not only to be ethnically neutral but also to promote investment in productive ways.

The new government that came into power in 1994 is committed to resolution of the ethnic conflict, restoration of democracy and social welfare, and an 'open economy with a human face'. The current debates in Sri Lanka center around all these issues. The government has already reintroduced fertilizer subsidies and price controls on some essential items, through in an *ad hoc* way. It has also launched a new poverty alleviation programme. Given the social democratic orientation of the government and the mandate it has received from the electorate, the question raised by many Sri Lankans is: *can the government refashion the state into a democratic developmental state ?* This is no mean challenge, given the dependence of the state on the World Bank and other external agencies for development funds.

On the other hand, the Sri Lankan situation puts the Bretton Woods institutions and the other external aid agencies to a test which centres on the classic conflict between political liberalism and economic liberalism. The new Sri Lankan government and the President won the elections on a pledge to democratize the country and provide employment to the unemployed and better conditions of life to all. Now, if the aid agencies insist on conditionalities that disfavor the implementation of these promises by the elected government, then they would be seen as opponents of the popular will of the people. On the other hand, the Sri Lankan government may not be able to bypass these sources altogether as its capacity to mobilize capital on the international market is rather limited. The current revival of trade unionism in Sri Lanka is also being viewed with alarm by local and foreign investors. Foreign investors may prefer authoritarian China or Vietnam to democratic Sri Lanka. Future trends in Sri Lanka would reveal the internal and international possibilities and constraints for a small and poor country like Sri Lanka to establish a functioning democratic developmental state.

India, which is comparable to China in terms of size and resource endowments, and internal economic and technological strengths, is likely to proceed on its own road to industrialization, in spite of its alliances with the Bretton Woods institutions. This prognosis is based on India's internal conditions such as the ones mentioned above, its political system which provides for pluralism and democracy, and, more importantly, the relative autonomy enjoyed by the Indian state. The Indian state has a long history of intervention and of using central planning to manage a mixed economy which was an outcome of deliberate political choice when the country won its independence. It has been called a regulatory state and not a developmental sate because it did not open the economy sufficiently to expose it to international competition and because of the poor performance of the public sector enterprises. However, the potential for the Indian state to become a democratic development state seems considerable given the possibility of combining the autonomy of the state and the dynamic multiparty political environment that already exists with carefully chosen economic reforms by learning from China and other East Asian countries.

Notes

1. A tradition of scholarship has been challenging the liberal interpretation of the political economic history of Western Europe (Polanyi 1957, Hirsch 1977, Bellamy 1992). A major pioneering work in this tradition is Karl Polanyi's *The Great Transformation*. Polanyi pointed at the 'double movement' of European history of the 19th century, one represented by the expanding market and the other by a counter-movement consciously organized by society to prevent or reduce the dislocations caused by the former. This double movement generated the imperatives for state intervention. The role of the state in the economy became most prominent in the West with the Keynesian revolution and after World War II (Gouverneur 1983). Hirsch (1977) defined and sought to explain the universal trend toward collective provision and state regulation of the economy in the 20th century West. The 'distibutional compulsion' (Hirsch 1977) and in more recent times environmental concerns have made the state more interventionist than before in developed countries.

2. The second industrial revolution involved emulation and learning in the early stages. In the 19th century, Britain was regarded as the 'workshop of the world'. English inventors and manufacturers were engaged in the continent from which technical missions also came to England to observe industrialization at first hand (Landes 1969).

3. Japan's industrialization began after the 'Meiji revolution' in 1868 when low-ranking samurai overthrew the feudal Tokugawa regime and established a state with the aim of building a 'rich nation with a strong army' (*fukoku kyohei*) through rapid industrialization. The new regime adopted a nationalistic/paternalistic ideology. The rebel samurai themselves were propertyless, though they belonged to a special class as warriors in feudal Japan but they believed that their country's future lay in industrialization. The Japanese state remained authoritarian and fascist until is was reformed after World War II (Fukui 1992). Taiwan's transformation began after the defeated Kuommintang (Nationalist Party) leaders and officials descended on the island from the mainland. They set up a one-party state on the island and launched the agricultural and industrial transformation of Taiwan with US assistance. South Korea's industrialization began after Park Chung Hee captured power through a coup in 1961. Park's justification of the coup was the urgent need to 'rescue the nation from the brink of starvation'. A nation of wealth and power was his dream (Koo & Kim 1992).

4. Concerning Japan, the repressive nature of the state applies only to pre-World War II times.

5. In Japan, agrarian reforms took place in stages. In the Meiji period (1868-1913), modern landed property was established without abolishing landlordism. The policy emphasis was on land improvement and productivity. The Meiji landlords invested in land improvement a part of the surpluses they appropriated from their tenants. During its occupation of Taiwan and Korea, the Japanese colonial regime introduced reforms to transfer land from outside absentee landlords to local landlords, and developed food production (mainly rice) with the motive of exporting cheap food to Japan. However, the Japanese countryside was dominated by landlordism which was resented by the tenants. The most radical land reform came to Japan after World War II when it came under American occupation. In the post-war reform, the old landlord class was completely eliminated and land was turned over to the tenants at nominal prices, and a ceiling was enforced on land ownership. In Taiwan, Chiang Kai Shek and his Kuomintang Party introduced a radical distributive land reform.

6. The real interest rate on long-term foreign loans channelled through the government in South Korea was negative for most of the expansionary decades of the 1960s and 1970s. This was because the rate of inflation exceeded the rate of currency depreciation. It may be recalled that the Park regime nationalized the banks and directly controlled credit supply. The government stood as guarantor for foreign loans and used that position to direct capital and credit and to impose discipline on the borrowers (Amsden 1989, 1990).

7. 'Ironically', remarks a Japanese development economist, 'Japan's industrial policies achieved unprecedented success by going against modern economic theory' (Shinohara 1982).

8. For example: Assume that the income elasticities of the following products are in the descending order: automobiles> textiles> agricultural commodities. Then, as exports, automobiles are more preferable than textiles which are better than agricultural commodities.

9. A WB study team in the 1960s 'expressed the view that an integrated steel mill in Korea was a premature proposition without economic feasibility' (Pohang Iron and Steel Co. Ltd. 1984, cited in Amsden 1989, p. 291).

10. 'An ironic indicator of the speed of its progress was a joint venture it entered into the United States Steel (USX) in 1986 for the purpose of modernizing USX's Pittsburgh, California Plant' (Amsden 1989, p. 291).

11. In Japan, in addition to supportive policies of these types by the government, major Japanese firms adopted the policy of lifelong tenure to ensure the internalization of externalities linked to skill development of the employees. Even though Japanese firms seem to be moving away from this tradition, the policy paid off during the entire industrialization process.

12. It may be added that with progress in industrialization the agricultural petty commodity producers progressively became part-time farmers and ful-time industrial workers, and as a result personal and household incomes rose in the countryside.

13. Such assertions have been made by economists such as Little (1979) and Lal (1983) (cited in Wade 1990) who appear to be desperate to defend or justify the neo-classical interpretations of the East Asian 'miracles' based on free markets and simulated free markets.

14. Based on the author's review of Central Bank Reports of recent years and of articles in the local media.

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