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THE DEVELOPMENTAL STATE: NEW PERSPECTIVES

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The “liberal market” model for how to structure and govern economies has provided the conceptual and normative center of gravity for global public policy since the ascendancy of neoliberalism in the 1980s. International economic organizations such as the IMF, World Bank, OECD and the Basel Committee on Banking Supervision think within this paradigm. The Washington Consensus on the appropriate set of policies to spur economic development in developing countries -- more accurately called the Washington-London-Brussels Consensus -- is derived from the liberal market model.

Despite all the material and ideational support behind the liberal market model, the big “emerging powers” or “emerging markets” -- notably China, India and Brazil – demonstrate pronounced differences between their institutional models and the liberal market model. And for all the differences between them, they share high-level similarities in economic institutions and the role of the state. To make the contrast with the liberal market model we could frame these similarities as the “developmental state” or “state capitalist” model.

As they gain relative economic weight compared to states championing the liberal market model, the big emerging powers are attempting to make changes to the governance and policy paradigms of international organizations, with the aim of making international regimes more accommodating and legitimizing of core features of their developmental states. (The irony is that the very term “emerging markets” achieved good currency because it carries the implied hope that they are emerging towards us and our liberal market model, which includes opening their large markets to our firms and investors.) But western countries led by the US and UK are pushing back, with much success both in terms of minimizing the increase in formal power to emerging markets (such as IMF quota) and in terms of keeping the liberal market

model as the center of gravity of global public policy. (Witness the marginalization of the so-called Stiglitz Commission of the UN General Assembly in 2009, tasked with investigating the causes and consequences of the global crash of 2008: Wade 2013a and 2013b.) We can anticipate that a tumultuous re-balancing in international relations over the next two decades or so will play out across many international fora. Not much will be heard of the “The Great Moderation” and “The End of History” that resonated happily through the period from 1990 to 2008.

But this anticipates the end of my argument. Now back to the beginning. I start with schematic accounts of the liberal market model and the developmental state model; continue with a review of three recent books relevant to the role of the state in governing economies; and then assess the prospects for a modified version of the classic developmental state in the current international context.

The liberal model for governing economies

We might summarise the liberal model as follows.

1. *Collective goals* (even winning out in international competition) are feeble motivators of personal economic behaviour. The only reliable motivator is self-interest -- the prospect of rents, profit or labor income.
2. Hence *the state* is kept “small”, taxation low, public enterprises have been privatized, markets substantially deregulated, and of course trade is free – all this in order to unleash the engine of economic growth, private profit-seeking enterprise. The state protects contracts and property rights and supplies or supervises private supply of collective goods subject to clear “market failure”, notably some kinds of infrastructure and health and education services.
3. The optimum degree of *integration between the national economy and the international economy* is maximum integration.
4. *Corporate governance* allows minority shareholders to govern, and is fully open to foreign financial investors and foreign takeovers.
5. *Capital markets* are largely free of state control, including free of state control of the inflow and outflow of foreign capital and of the establishment of foreign financial firms; major corporations are oriented to global capital markets;

investors tend to be “impatient” in the sense that they are prompted to cut and run by a few quarters of lower-than-expected profits, and invest elsewhere.

6. Within a broad state-set framework of rules about work conditions, *labor relations* are set at firm level, and trade unions have little power vis-à-vis employers.
7. The interest rate and the budget deficit are the central macroeconomic tools; both are kept low.

This model is derived from the core belief of the economics mainstream. As articulated by an economic journalist:

“To be an economist in the United States, you have to believe that the market works most of the time. The situation in which markets don’t work, or cannot be made to work, is really quite exceptional, and not all that interesting to study... [T]he boundaries between who is considered mainstream, and who is not, are enforced quite fiercely” (quoted in Fourcade, 2009, 61).¹

Or in the Old Testament certitude of Fred Smith, founder and chairman of the Competitive Enterprise Institute, Washington DC, writing in *The Financial Times*:

“Instead of trying to transform the global economy to please its least sympathetic observers [he cites Lynn Forester de Rothschild, Charles Dickens, Michael Moore, Naomi Klein, John Mackay, and Bill Gates], we should encourage entrepreneurs, executives and investors to tell the *real story* about how markets expand prosperity and opportunity *wherever* they are allowed to be free” (Smith, 2014, emphasis added).

The developmental state model

We might summarize the developmental state model as follows.

1. It has a level of *taxation* (perhaps supplemented by aid) sufficient to provide public expenditure on physical infrastructure, education and health, significantly higher than in economies following the liberal market model, in the

¹ American economics is the gold standard for world economics. Of the 63 Nobel Prizes awarded in economics between 1969 and 2008 93 per cent went to Americans or non-Americans who taught in the US for long periods.

richer developmental states equivalent to at least 35 percent of GDP.

2. It has a population with a sufficient sense of *solidarity*, homogeneity and collective purpose to accept the levels of taxation required (acceptance perhaps aided by authoritarian state controls and perception of encompassing threats from other states).
3. It has an *elite civil service* (elite = brainy + morally committed to public service + institutionalized in a civil service career structure, as distinct from a New Public Management task-based structure). The civil service is sufficiently independent to share decision-making power with ministers. Independent means appointments and promotions are insulated from political party control; it does not mean insulated from dense contact with the private sector or politicians.
4. The elite civil service has sufficient *knowledge of technological developments* to “pick winners” -- i.e. provide subsidies for the promotion of those “infant” industries which have high income elasticity of demand but whose prospective rates of return are not sufficiently attractive to attract private investment early on.
5. *Industrial policy* is focused broadly on developing the capacities of *indigenous firms in major global industries*, able to act as first-tier suppliers to MNCs and, later, some able to compete head-to-head with MNCs.
6. *Corporate governance* of major companies is in the hands of national capital, which may be families, other companies, banks, or the state. There is not much of a market in corporate control.
7. *Capital markets* are controlled by the state, and the state regulates the inflow of foreign capital and the establishment of foreign financial firms. Much corporate finance comes from internal savings; and most of the external financing is patient capital. So major companies are relatively insulated from the profit expectations of international investors.
8. *Labor relations* are split between a well-regulated sector with encompassing and cooperative trade unions substantially under state direction, and a much less protected sector, where working conditions are set at firm level.
9. The *exchange rate* is managed to keep it sufficiently “devalued” not just to keep the current account deficit low,

but to provide those infant industries with profitable access to foreign demand, as well as domestic demand.

10. *Innovation and diversification* in the domestic economy occurs mainly through state-tolerated counterfeiting, reverse-engineering, buying foreign technology (as distinct from full-management foreign direct investment), and production assistance from foreign buyers. Over time the state builds up state-financed R&D facilities and begins gradually to strengthen intellectual property rights.

Development economics tends to associate this model with South Korea, Taiwan and (with qualifications) Singapore from the 1950s to the 1980s and to some extent beyond (Wade, 1982; 2004). But it was pioneered by Japan and France, and diluted versions were widely accepted in the advanced industrial countries from the end of the war to the 1970s oil shocks. These versions ran into trouble in the second half of the 1970s thanks to a combination of high inflation and recalcitrant trade unions. Both Japan and Britain had inflation rates of 23% in 1975. Japan, with cooperative unions and a synchropay system (a grand national negotiation once a year), got inflation down to a single digit in two years. Britain, with more bolshie unions and a throughout-the-year, industry by industry, “leapfrogging” bargaining system, still had double digit inflation when the resulting chaos brought Mrs. Thatcher to power and she enforced swingeing deflation on the Volcker model which had already ushered Reagan to power (Dore, 2014).

Thereafter, the World Bank, the IMF, the OECD and other global public policy opinion-makers operated in the grip of Anglophone governments and Anglophone economists imbued with the premise of “To be an economist in the United States, you have to believe that the market works most of the time” (the last place they looked for lessons was Japan or France). So this developmental state model became discredited; and along with it, the whole idea of industrial policy. The very phrase “picking winners” became a term of abuse. As Gary Becker pronounced, “The best industrial policy is none at all” (Becker, 1985).

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Most economists were at a loss to explain the paradox that many developing countries experienced better economic performance in the 1960s and 1970s, when they had a lot of import substitution policy, than they did post-1980, as their policies and institutions moved in the direction of the neoliberal consensus. The popular economist William Easterly made this puzzlement quite explicit:

“It is a bit of a *mystery* why they [developing economies] did well.... The growth had a lot of *mystery* for me It is *mysterious* to those [like me] who advocate hands-off markets” (Easterly, 2002, emphasis added).

This, when Easterly had been working on development issues for 21 years, most of them in the World Bank.

Even in the more eclectic, less neoclassically-oriented discipline of development studies, the idea of the developmental state has remained on the margins of good currency. A recent book-length study of the *discourse* or language of development studies, which discusses the more prominent concepts deployed over the years, makes no mention of the developmental state; indeed, virtually no mention of the state, except for, “failing state” (Cornwall and Eade, 2010).

The developmental state literature: the economics school and the political school

Still, a literature on and around the developmental state does exist on the margins of academic respectability. Here I consider three recent contributions.

The first is *Beyond the Developmental State: Industrial Policy into the Twenty-first Century*, edited by Ben Fine and others. It usefully identifies two schools within the literature: the economics school and the political school.

The economics school comprises studies which focus on policies, mainly the “interventionist” policies of the success stories like Japan, France, South Korea and Taiwan. The central theme of this school is that the success stories do *not* reveal close policy adherence to the Washington–London-Brussels Consensus (as in the first model above) that the state should limit itself to providing the physical and institutional framework necessary for free market forces and ensure that prices are allowed to be “right” (not distorted by monopoly or trade protection or inside-the-border barriers to international trade). The success stories undertook much more directive policies and regulations (“dirigiste” is the word of choice for the critics), where the state “governed the market” and imparted directional thrust -- while relying on private profit-and-rent-seeking market agents for most resource allocation decisions, especially in the small and medium enterprise sector as distinct from the oligopolistic sector. The economics school tends to focus on a specific set of policies, namely protectionist trade policies, preferential credit, and investment coordination and promotion across the industrial sector; and tries to answer the question of how these “interventionist” policies plausibly contributed to development success, contrary to neoliberal theory.

The political school focuses more on how the state is organized so as to provide directional thrust towards collective development goals -- in contrast to the common case where an incumbent elite uses state power to distribute power and resources towards its members and away from both public goods and would-be state incumbents. Studies in the political school often start from the common image of public agencies in middle- and low-income countries being sources of patronage and sinecures, allocating goods and services like jobs and public contracts in a way that fortifies this pattern. Staff are commonly left to their own devices while heads of agencies busy themselves with personal business and political networking. Therefore, all governance — including of interventionist industrial policies — operates in an environment hostile to state effectiveness. (For the case of Palestine, see Wade, 2013c.)

Given this standard image, the universal solution prescribed by western-run development agencies such as the World Bank is the tightly circumscribed role of the state described earlier; and within that, a “good governance” agenda (not “good government”, which sounds too political) emphasizing transparent and standardized procedures for government business, including public procurement (so our firms can compete on a level playing field with theirs in their markets), and priority in public investment to meeting standards prescribed in international agreements. So customs offices should be computerized (implicitly, ahead of schools and hospitals), and scarce resources should be allocated to establish a national patent and copyright regime in line with the WTO’s Trade-related Intellectual Property agreement, for example.

In contrast, the political school of the developmental state literature identifies the “magic bullet” — or the necessary but not sufficient condition for success — as “relative” or “embedded autonomy” of the state. The successful developmental state manages to be independent of, responsive to and steering of non-state agents; and uses its powers to implement interventionist policies along the lines of the economics school (Evans, 1995). The unsuccessful developmental state pursues interventionist policies but to generally bad effect because captured by special interests and therefore lacking in relative autonomy and probably lacking in expertise as well (see post-1994 South Africa).

While descriptively rich, literature on the developmental state often hovers on the brink of tautology by failing to give clear criteria for distinguishing “embedded autonomy” from either “embedded” or “autonomy”, and successful “developmental” state from unsuccessful “developmental” state and from other kinds of states. It often comes close to conflating the developmental state with the effective state, and the effective state with one whose economy is successful.

State capacity, violence and prosperity

Here we can bring in Timothy Besley and Torsten Persson’s *Pillars of Prosperity*. The book hardly mentions the developmental state as such, but it does address the determinants of “state

effectiveness” in ways that avoid tautology. In particular it seeks to identify “the incentives or ability of government to put the economic institutions that would make policy effective in place” (308). To this end it deploys a more formal microeconomic approach than used in developmental state literature, complete with mathematical models of institutions and incentive structures and lots of cross-country regressions. The object is to identify some of the conditions which enable states to become effective: capable of taxing, enforcing contracts, and spending developmentally.

The authors find a high correlation (or “cluster”), state by state, between (a) state capacity, (b) peaceful resolution of differences (inversely, propensity to civil conflict), and (c) per capita incomes. So societies with relatively high capacity states also manifest relatively peaceful resolution of differences (low propensity to civil conflict) and relatively high average income, in complex co-determination.

The authors identify three components to state capacity:

- (1) fiscal capacity (administrative infrastructure for raising taxes with a *broad base*, such as income tax as distinct from tax on concentrated resource rents);
- (2) legal capacity (support for property rights and limits on private and public predation);
- (3) capacity to make productive infrastructure investments (roads, power systems, etc.).

Low capacity states experience a negative feedback loop, as low legal capacity yields low tax collections, which reinforces weak institutions. All these variables can be measured with existing data sets, which the authors use for extensive empirical tests.

The authors argue, first, that a state’s level of capacity constrains the policies which the government is able to implement with something close to the intended effects; and more directly constrains development in the private sector by weakly defining and enforcing contracts and property rights. They argue, second, that the government makes investment choices which can raise, or lower, *future* state capacity, and hence affect the choice of future policies and the enforcement of future contracts and property rights, and hence affect future growth.

The key question concerns the determinants of the government's decision to invest in state capacity. Such investments raise the state's fiscal capacity (capacity to extract resources via broad-based taxes), legal capacity (support for property rights and contracts), and productive capacity (capacity to provide infrastructure).

The government is likely to invest more in state capacity — and in public goods generally (as distinct from goods for itself and its close supporters and financiers) — when it is constrained to treat opposition groups well; constrained by institutional checks and balances on the executive, or by election systems that grant representation to electoral losers or ensure dependably regular and fair elections. Why? Because then incumbents are more confident that if they invest now in expanding state capacity, the higher state capacity will not be used against them and their interests in the future, when they are out of power.

Where these constraints on executive power are weak, incumbents are more likely to devote state resources and rig markets to enrich themselves and build police and military loyal to *themselves* rather than to the state as such (think of Gaddafi). Their investments in pre- and re-distributing to themselves and in bolstering the police and military apparatus loyal to themselves in turn induce would-be incumbents to invest more in the means of violence. Both sides devote more of the economy's investible surplus to raising the probabilities of maintaining or seizing authority. Hence state capacity is likely to be relatively low, the propensity for civil violence high, and per capita incomes low. The key variable is constraints on the executive.

The empirical tests undertaken in *Pillars of Prosperity* seem to provide impressive support; but they are mainly cross-sectional. It would be interesting to trace how the three sets of capacity variables have moved across time in more successful development catch-up cases compared to less successful ones; for example, trace how Taiwan and South Korea scored on these variables in 1960, 1970 and on, as compared with the Philippines and Thailand. And we could apply the analysis of constraints on the political executive and the resulting incentives to invest in state capacity to answer the question of why political executives in the former cases adopted the "right" interventionist policies and not so much in the latter, which would take us beyond the implicit simple-minded

assumption in much of the economics school that developmental states implement the right “interventionist” policies because they are the right policies.

Effective industrial policy agencies

In contrast to Besley and Persson’s approach, *The Politics of Public Sector Performance: Pockets of Excellence in Developing Countries*, edited by Michael Roll, uses an inductive, “thick description” approach to identify characteristics of state agencies which distinguish themselves from the surrounding bureaucratic swamp by effectiveness in carrying out their mission. These are “islands of excellence” or “pockets of effectiveness”. The case studies range across Brazil (the National Development Bank), Nigeria (National Agency for Food and Drug Administration and Control), Surinam (State Oil Company), mainland China before 1949 (Sino-Foreign Salt Inspectorate), Taiwan after 1949 (Joint Commission for Rural Reconstruction), and state-owned enterprises in rentier states. The concluding chapter by Roll induces several necessary conditions for “pockets of effectiveness”.

The first necessary condition is a strong head of government (or a small, coherent elite), which has strong interest in particular tasks — like industrial diversification and upgrading — being done effectively. His or her motives may be defence against external enemies, national prestige, or international prestige. Pressure from the World Bank, other regional development banks or aid agencies may be influential but not decisive.

Second, the head of government breaks with normal — that is, patronage — appointment criteria, possibly against a lot of elite opposition. Instead, criteria for appointment to top positions in the agency (such as an industrial policy agency) emphasise technical qualification, proven leadership and proven incorruptibility. The agency director (or CEO) comes from *outside* the inner elite, and is connected to it through “weak ties”; hence is less vulnerable to the “insider’s dilemma”, the requirement for members of the elite patronage network to allocate jobs, contracts, and other public resources to other members of the elite network or else risk their own career and effectiveness.

Before the appointment the original tie between the CEO-to-be and the president is a weak one; they usually do not know each other very well, because the candidate comes from outside the inner elite. But once selected, the link between the CEO and the president becomes a *strong* one, because the CEO depends heavily on the president's support and the president has to defend him/her against the established elite's attacks. However, the link to the rest of the elite remains *weak*.²

Third, the strong tie to the head of government helps to secure the necessary bureaucratic autonomy — necessary because the agency will often conflict with politicians and firms with contrary interests (e.g. firms wanting continued protection despite non-performance). Autonomy is not a condition which is fixed, based on law; paradoxically enough, *autonomy depends on political connections and is inherently relational*. Agency managers must constantly manipulate their external environment to secure their autonomy, using connections to politicians, corporations, unions and other powerful entities.

Fourth, the director must be free to appoint members to the management teams, and select staff committed to the mission (“principled agents”). Most come from outside political elite networks (some from private companies or overseas). Salaries and benefits are higher than in the regular civil service. However, the ethos of the agency is such that performance does not depend mainly on extrinsic incentives; staff work conscientiously mainly because of *intrinsic* incentives, because they see their job as meaningful. Intrinsic motivation helps agency effectiveness because it reduces the director’s costs of controlling staff; in the terms of principal-agent analysis, it reduces the principal’s cost of controlling agents. This mechanism puts added responsibility on the director to foster the staff’s organizational identity and internalized responsibility for the mission.

Fifth, an agency which aims to be a “pocket of effectiveness” in a bureaucratic swamp must change internal and external expectations of the agency’s modus operandi. The two key instruments are: (1) standardization of procedures (for example, procedures for project appraisals and project decisions); (2)

² For an Icelandic case study of how those subject to the regulatory attention of an agency headed by such a CEO can go about neutralizing him, see Wade and Sigurgiersdottir, 2014.

regular evaluations of agency performance. In relations with the outside, standardization enhances predictability for clients and reduces the incentives for bribes. In relations within the agency standardization raises staff confidence in the information they receive from others, rendering it unnecessary for them to check it for themselves.

This is a useful check-list of factors making for bureaucratic effectiveness, which takes the discussion beyond the standard neoliberal claim, “governments [undisaggregated] can’t pick winners”; and also takes it well beyond the broad-brush accounts of the organization of industrial policy agencies in the political school of the developmental state literature. It would be interesting to do a parallel exercise to that proposed for Besley and Persson, namely to trace these necessary conditions across time in the industrial policy agencies of Japan, France, South Korea and Taiwan.

It would be equally interesting to do the same with certain US federal agencies. Agencies such as the Defence Advanced Research Project Agency (DARPA), National Institutes of Health (NIH), National Institute of Standards and Technology (NIST) have over the past two decades, at least, implemented a form of industrial policy which entails the agency helping to create cooperative networks between firms, sources of finance, and universities to accelerate innovation in agency-identified directions. This form of US industrial policy has escaped public attention, because there is no superordinate “industrial policy agency” akin to Japan’s Ministry of International Trade and Industry (MITI) in the post-war decades, and because the agencies have tried to keep their network-building and direction-setting programs below the radar of conservative public attention (Mazzucato, 2013; Block and Keller, 2011; Lind, 2012; Schrank and Whitford, 2009; Wade, 2014).

Weaknesses of the developmental state literature

The literature reviewed here shares the conclusion that the state should have a more active role in accelerating industrial upgrading and diversification in developing countries – a more active role than enjoined by prevailing prescriptions to “leave upgrading and diversification to the market”. (*Pillars of Prosperity* is a partial exception, being focussed on a broader

notion of state effectiveness at carrying out even the basic Adam Smith functions.)

But these studies reflect several weaknesses seen in much of the literature on “bringing back the state”. First, they make no distinction between governance models appropriate to different types of developing countries, and in particular, no distinction between very large developing countries, including China, India and Brazil, and the great mass of medium and small-sized ones. Having a large internal market provides scope for a more “developmental” role of the state than not having a large internal market.

Second, in focusing on the state itself, they short-change key features of the wider domestic political economy, notably corporate governance, capital markets, and labor relations.

Third, they tend to treat the state like a runner in a marathon race, whose position is determined by *internal* capacity. They are not good at linking the role of the state with international economic and financial regimes, which provide opportunities and constraints on state action – which differ, however, between very large developing countries and the rest.

Today, an obvious objection to the prescription of a more active role of the state in steering production diversification and upgrading is that WTO rules substantially curtail it (Wade 2003). Even more so would the rules of the mega-regional trade agreements now under negotiation, such as the Transpacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP), severely curtail it.

A second major objection is that world trade, technology and brands have become highly concentrated in the hands of a small number of multinational corporations based in the West or Japan – more concentrated than when Japan, France and the East Asian Newly Industrialized Countries pioneered the developmental state.

Firms in present-day would-be developmental states face high entry barriers in the main industrial sectors (in the higher value-added segments of cars, chemicals, petrochemicals, electronics). Even developing country firms on the world *production* frontier find it difficult to escape the role of “original

equipment manufacturer” for the big-name western and Japanese firms, and develop their *own* brands.

So it can plausibly be argued that the more viable route for firms in medium and small-sized developing countries is to embed themselves in rather than seek protection from the major global value chains dominated by MNCs. But if this is the strategy, the government will be under strong pressure to follow neoliberal norms, such as those enshrined in investor–versus-state arbitration requirements (Pirie, 2013).

The case of the Korean semiconductor industry offers a cautionary tale (Al-Jazaeri, 2013). The entry of South Korean firms into semiconductors in the 1980s (including Samsung, LG and Hyundai) was led not by the state but by American and Japanese frontrunner firms, which invested directly in plant and equipment, and provided credit and market access (they were supported by their states, for geopolitical reasons). But once the Korean firms had established such excellent production capacity that they were closing in on the world frontier the government stepped up its direct support. The Korean firms succeeded so well that they even leapfrogged the frontrunners, introducing the 64M DRAM and 256M DRAM *ahead of the frontrunners*. But then, with the ascendancy of neoliberal economics throughout the Korean government in the 1990s (payback for generations of Koreans schooled in US graduate economics programs), the government cut back support -- and Korean firms fell off the frontier.

Something perverse happened. The state did continue to give credit and tax subsidies for *export* performance (across many sectors). This “horizontal” promotion policy helped to *block* the semiconductor firms’ challenge to the western and Japanese leaders, by giving them a strong incentive to emphasize output growth rather than profitability and technological depth. The result is that for the past decade and more the Korean semiconductor firms have been stuck in a relatively low rank in the technology architecture of microelectronics, in the relatively low profit parts of value chains. While they excel in manufacturing, they remain heavily dependent on the strategy of quick installation of core components, equipment and designs from western and Japanese companies. They have not been able to break into the making of microprocessors or their own equipment, where market leadership and high profits lie. If these Korean firms can’t do it, who can?

Rescuing the idea of the developmental state: Mark I and Mark II

The combination of the two factors — neoliberaally-inspired trade and investment rules, and high entry barriers in the face of existing MNC dominance — means that the developmental state a la Japan, France, South Korea and Taiwan (focused on developing the capacities of *indigenous firms in major global industries*, able to act as first-tier suppliers to MNCs and even to compete head-to-head with them) is no longer a viable proposition, except for a few economies with very large internal markets, China, India and Brazil most conspicuously.

But if the developmental state Mark I (where the capitalist state leads the creation of a diversified and autonomous industrial base) is now viable only for very large developing countries, that is not the end of the story. There is more scope for developmental state Mark II.

First, WTO rules are more constraining for some policy instruments than for others: more constraining for tariffs, quantitative restrictions, local content requirements; medium constraining for government procurement, intellectual property, export subsidies in agriculture; and least constraining for devaluations, investment incentives, trade finance and export taxes, for example.

Second, the state can act more, or less, strategically in attracting selected portions of global value chains into its territory. It can bargain hard with a multinational corporation so as to maximize the transfer of skills into the heads of citizens, or it can let the corporation decide by itself how many citizens to employ in which stages of which operations. Throughout the fast catch-up phase the South Korean and Taiwanese governments bargained hard with incoming MNCs, in a way that governments in many other developing countries (Chile and Hong Kong, for two) did not.³ Indeed, some studies argue that policy makers in South

³ Enos and Park (1988) report that in the 1970s, when the governments of South Korea, Chile and Hong Kong ordered the same ethylene plant from Dow Chemicals, the Koreans pressed Dow much harder to employ nationals across the several stages of the project; and the ratio of nationals to regular Dow employees increased in each of the two subsequent plants Korea ordered from Dow. This case fits

Korea and Taiwan continue to practice activist industrial policy, even as they, following the American example (above), keep their interventions much more covert than in the past.⁴

In other words, the leaders of a state may buy into the prevailing liberal ideology that they can best promote development by concentrating on improving the institutional and physical framework for markets, in the hope that private profit-seeking investors responding to incremental price signals will diversify and upgrade production sufficiently to keep incomes rising. Or they can use the remaining room for policy manoeuvre to make non-incremental jumps in the product and technology space, in the spirit of developmental state Mark II. In countries as varied as Britain, Argentina, and Nigeria state leaders *could* still today undertake entrepreneurial roles,⁵ even accepting that anything like the developmental states of East Asia of the post-war decades — building up indigenously-controlled major industrial sectors in cars, chemicals, petrochemicals and electronics — is unlikely.⁶

Indeed, new evidence suggests that since 2008 and the long slump, many developed and developing country states — whatever they say — have moved further away from “level playing field” policies and intensified *policy selectivity* by sector, location and ownership. This is the finding of Vinod Aggarwal and Simon Evenett (2010), who draw on the Global Trade Alert (GTA) data set for the US, major EU countries, China, India, Brazil, Argentina and others. Much of the resulting “industrial policy” (though generally not called that) is directed at “green” products and processes, which softens neoliberal censure (though not as much as “military” does). States have generally avoided tariffs and quantitative restrictions (which, as noted, are in the “more constrained” category of WTO rules). They have employed modes subject to “medium” or “low” WTO restraint, such as public procurement, discriminatory subsidies and bailouts (“murky protection”).

the Korean motto, ‘We never learn anything twice’, a motto I heard during my field work in Korea in 1979 (Wade, 1982).

⁴ See Chu (2009), who asserts, “In seeking to attain its development goals, the Korean state articulates visions and deploys public resources to structure the market and shape innovation”.

⁵ While even a state like Britain *could* undertake an entrepreneurial role, the December 2013 report of the UK House of Commons liaison committee about the future of the civil service identified a fundamental problem in the pervasive “belief in incremental change versus long-term vision” (Jenkins, 2013).

⁶ For a discussion of ‘state leadership’ and ‘state followership’ as modes of industrial policy, see Wade (1990).

In short, since 2008 the quantum of industrial policy has gone up, especially for green investments. WTO rules have affected the *composition* of industrial policy instruments rather than curbing the *quantum*.

The developmental state Mark II model is all the more important for the many middle-income countries which find themselves in a competitive vice: their producers cannot compete with low-wage countries in standard goods, and do not have capabilities to compete in exports of skill- and knowledge-intensive goods and services. China's position as workshop of the world across a wide range of manufactured products — more accurately, assembly workshop of the world, drawing on parts and components produced elsewhere, particularly in regional value chains spanning East and Southeast Asia — intensifies the squeeze on others. Across whole swathes of manufacturing, China has enjoyed absolute cost advantages over producers elsewhere, not just relative cost advantages, and its exports have been knocking out manufacturing employment in both middle- and high-income countries (Paus, 2012). The idea that governments should hew to neoliberal principles in response to this competitive squeeze — or limit themselves to investing in the basic Besley-Persson ingredients of state capacity — and leave the outcome to the incremental profit-seeking decisions of private agents is, put politely, debatable.

But the alternative prescription for a more active role of the state does raise a big question which much of the literature ignores. The literature tends to begin with the state and then ask how it can be effective in promoting development. As we saw, one main line of answer invokes internal characteristics of the state (bureaucratic organization, pockets of effectiveness, etc.), plus substantial state control to regulate and guide private business while also working with — or being “embedded” with — business or peak organizations of business. But the nature of the state itself derives from more comprehensive state–society relations (Chang, D-O, 2013). A state which exists in conjunction with a cohesive capitalist class and a disempowered and depoliticized labour class (or classes) will have a different nature — different level of capacity, different policies — than one where a cohesive capitalist class is balanced by an empowered labour class, or than a patrimonial state where leaders generate no purposeful power

beyond sustaining themselves and the state hardly penetrates the rest of the society (think of some of the Arab regimes which collapsed after 2010) (Kohli, 2004).

The short answer to why the East Asian capitalist developmental states took the form they did is that (a) their societies faced external state enemies capable of overwhelming the whole society, which generated wide acquiescence to state discipline and taxation, and (b) the owners and managers of capital consented to state direction in exchange for tight control over collective labour, in response to episodes of labour unrest early on. The famed “embedded autonomy” of the East Asian developmental state came out of co-determination between external military threats, class relations, and Besley-Persson-Roll state capacity.

On the other hand, the long history of the liberal (non-developmental) British state came out of the “outward-oriented alliance” between finance, big companies and the state going back to the middle of the nineteenth century. British capitalists lifted free from investing in Britain long before their counterparts in continental Europe, as seen in higher levels of trade and foreign direct investment relative to GDP than in other economies of comparable size, such as Germany and France. As the once thriving industrial heartlands in northern Britain shrank through the twentieth century, the state’s response was limited to redistributing tax revenues from south to north, largely in the form of welfare payments, while hoping for a spontaneous renaissance in the regions — hoping for the past 100 years (Wade, 2007). Any politician or economist who proposed a vision of the economy’s future growth including rebalancing the regions would be dismissed with a reply along the lines of Helmut Schmidt’s, “People who have visions should see a doctor”.

Conclusion

Ideas from the developmental state model can be brought back into good currency in the debate about international development on the back of the following points.

First, the transition from the levels of income, productivity and production sophistication associated with middle-income countries to those of the developed countries is very difficult. The

number of *non-western* countries which have become developed in the *past two centuries* is less than ten, even stretching the categories of non-western, country and developed. They include Japan, Russia, Taiwan, South Korea, Singapore, Hong Kong and Israel. All faced external state enemies ready to swallow them up. None of them — with the partial exception of Hong Kong — followed policies closely aligned to the Washington–London–Brussels Consensus, except that they all undertook market liberalization as they became richer, which is quite different. All of them had authoritarian political regimes — or formal but not substantive democracy — until late in their development, with the partial exception of Israel.

Second, today's large developing countries operate with a political economy model that deviates in significant ways from the liberal market model prescribed by the Washington-London--Brussels Consensus as best for developing countries; though they may declare allegiance to the liberal model for the benefit of western audiences. We noted, above, how their institutions of corporate governance, capital markets and labor relations are shaped to give the state a large influence; and how their governments give central importance to managing the exchange rate as a tool of macro as well as industrial policy (as the liberal market model does not).

Third, as some emerging powers become more powerful in international organizations they will use their power to block western moves to further institutionalize western liberal norms and standards as global ones, and promote new norms and standards which better fit the developmental state model. We have already seen them resisting the G7's, OECD's and IMF's concerted attempt to lay down universal standards for corporate governance in line with the liberal market model (the IMF's framework is called Reports on the Observance of Standards and Codes, ROSC: Wade, 2007a). They have fought back against the efforts of the London-based International Accounting Standards Board to require an open market for corporate control. They have helped to bring about a recent significant shift in the IMF towards a more tolerant view of "capital flow management" (aka capital controls), which is important for their efforts to manage their exchange rates.

Fourth, the debate about the developmental state should be informed by the recent research on the US's disguised or hidden

developmental state. This research shows that the US — by far the most innovative major economy in the world — has long practiced selective industrial policy, while successfully persuading the world that it follows (more or less) neoliberal norms and prescribing that others must too, in their own and the global interest.

Fifth, invincible though the liberal market model still seems in the West — even to the point of generating a near-consensus that the Eurozone crisis is a sovereign debt crisis, the result of government profligacy, rather than a crisis of excessively leveraged private banks — it will not survive as the centre of gravity of global public policy. The challenges of dematerializing economic growth, curbing the concentration of income and wealth, and integrating emerging powers into global governance will force the erosion of neoliberal norms. But western states will continue to resist, because having the liberal market model accepted in the rest of the world gives them substantial advantages in protecting their position at the top of the global hierarchy of wealth and power (Vestergaard and Wade, 2013; Vestergaard and Wade, 2014). The likely result is a downgrading of multilateral organizations like the World Bank and IMF, an upgrading of more informal, minilateral organizations like the Chiang Mai Initiative Multilateralization and the BRICS development bank, more fragmentation of global rules. All told, a less liberal international economic order — for better or worse.

In the context of a more fragmented global governance regime, two big questions are: how to institute “traffic systems” between the more diversified regimes, so as to reduce transaction costs without everyone having to play by the same rules; and how to handle problems generated at the global economy level, such as the destabilizing effects of making countries running current account deficits cut their deficits while placing surplus countries under no pressure to cut their surpluses (with the US, of course, being the one main exception to asymmetric adjustment pressure on deficit countries). END

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