The Developmental State: Miracle, Crisis and Restructuring

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Outline of the Lecture

• Explaining the East Asian miracle
• The developmental state
• The prototype developmental states: Japan, South Korea, Singapore and Taiwan
• Southeast Asian tigers: Thailand, Malaysia, Indonesia and the Philippines
• China as a new developmental state?
• The Asian financial crisis in 1997~98
• Post-crisis restructuring in Northeast and Southeast Asia
• Towards an Asian model of developmental state
Explaining the East Asian miracle

• The ‘East Asian Miracle’
  • A World Bank report published in 1993
  • High-performing East Asian economies (HPAES)
  • Essence: ‘rapid growth with equality’

• Rapid economic growth in East Asia
  • Japan in the 1960s and 70s
  • South Korea, Hong Kong, Singapore and Taiwan in the 1970s and 80s
  • Thailand, Malaysia, Indonesia and the Philippines in the 1980s and early 90s
Explaining the East Asian miracle

• WB’s account of the ‘East Asian Miracle’
  • Good fundamentals, selective interventions, high quality institutions
  • Market-based competition
  • Outward oriented (export-led) growth strategies

• The neo-classic view of ‘getting the basics right’: the market forces worked

• The revisionist view of ‘getting the prices wrong’: state intervention essential
Explaining the East Asian miracle

• Two essential conditions for economic growth (Rodrik, 2014)
  • Development of fundamental capabilities in human capital and institutions. These fundamentals are multidimensional, have high set-up cost, exhibit complementarity, and depend on long-term accumulation
  • Expansion of higher-productivity industries and the corresponding transfer of labor. It requires the structural transformation of industrialization

• Achieving short-term and long-term economic growth
  • Fostering new industries often require second-best policies that facilitate structural transformation but are in tension with the fundamentals
  • As the economy develops, the dualism between modern and traditional sectors disappears. The fundamentals then become the dominant force over structural transformation
The developmental state

• Searching for the political underpinnings of miraculous economic growth in East Asia

• Three key characteristics of the developmental state
  • Growth-oriented state policies
  • Bureaucratic competence and autonomy
  • Close government-business relationship
The developmental state: growth-oriented

• Predatory state vs. developmental state (Doner, Ritchie and Salter, 2005)
  • Harsh and uncertain international environment
  • Lack of natural resources and raw materials
  • Necessary side payments to maintain a broad political coalitions
  • Economic growth becomes one of the key objectives of the state

• State intervention and economic growth
  • Industrial policy to facilitate industrial upgrade
  • Strategic trade policy to protect domestic producers and introduce international competition
  • Other policies on rural development, education, and social welfare
The developmental state: bureaucratic competence

• A Confucian tradition and legacy?

• Competent state bureaucrats
  • Talented candidates and competitive recruitment
  • Meritocratic promotion and institutional competence
  • Less vulnerable (if not completely immune) to corruption

• Bureaucratic autonomy
  • (Relative) autonomy from societal pressures
  • Prioritizing policy imperatives over political compromises
  • Organizing pilot agency and conducting policy experiment
The developmental state: government-business coordination

• The rationale behind the close government-business relationship
  • The growth-oriented government policies support and guide the business sector’s commercial activities
  • The success of the business sector fulfills the state’s growth objective and lends legitimacy to its interventionist policies

• Institutional arrangement
  • (Spontaneous or engineered) business associations
    • Coordinating business activities, representing business interests, and facilitating government-business exchanges
  • (Institutionalized) government-business linkages
    • Regular meetings between government officials and business leaders, offering mutual support in policy-making and implementation
The prototype developmental states: Japan, South Korea, Singapore and Taiwan

• Japan – the original model of the developmental state
  • Ministry of International Trade and Industry (MITI) → METI
  • Keidanren, (日本経済団体連合会, Japan Business Federation)

• South Korea and state-directed development
  • Park Chung Hee (1917-1979)
  • The *Chaebols*, strategic credit allocation, ‘getting the prices wrong’

• Singapore and industrial upgrade
  • Lee Kuan Yew (1923-2015) and the People Action Party (PAP)
  • A clean and efficient bureaucracy; Economic Developmental Board (EBD)

• Taiwan, and small and medium-size enterprises
  • Decentralized government authority, using public enterprises to push for new sectors, and relying on arm’s length incentives to guide the private sector
Southeast Asian tigers: Thailand, Malaysia, Indonesia and the Philippines

• Southeast Asian tigers in comparative perspective
  • Political coalitions: prioritizing the ethnic majority
  • Bureaucrats: less competent and less autonomous
  • Government-business relationship: vulnerable to crony capitalism
  • Weak developmental state

• Key features of individual countries
  • Thailand: changing authorities, weak/intermediate state, and uneven development
  • Malaysia: New Economic Policy (NEP, since 1971) and National Development Policy (NDP, since 1990)… to support the bumiputera
  • Indonesia: ‘New Order’ in the Suharto years (1965-1998) → decentralized oligarchy
  • Philippines: limited growth and widespread corruption in the Marcos era
China as a new developmental state?

- Economic reforms and ideological repositioning since 1978
  - From socialist planned economy to (socialist) market economy
  - Redefining the state’s roles in economic management
  - Reforming the state-owned enterprises (SOEs)
  - Allowing, supporting, and then encouraging the private sector
  - Embracing the international market through trade, investment, and foreign aids

- Behind the extraordinary economic growth in China
  - The state’s strategic planning and investment
  - SOEs’ dominance/monopoly in key sectors
  - Government-sponsored overseas business expansion
  - The rise of state capitalism?
The Asian financial crisis in 1997~98

• Background of the crisis
  • The domestic banking sector and financial market in major East Asian economies were liberalized in late 1980s and early 1990s
  • By mid-1990s, the inflow of short-term investment overtook long-term FDIs (and most were unhedged)
  • Macro-economic structure: fixed exchange rate and high interest rate created domestic asset-price bubbles
The Asian financial crisis in 1997~98

• Speculative attack against the Thai Baht forced Thailand to float its currency in July 1997; quick depreciation and massive capital flight ensued

• Panic among international investors spread to other structurally similar but macro-economically healthy neighboring countries (esp. Malaysia, Indonesia, and South Korea)

• The IMF offered emergency assistance under the restrictive conditions of domestic reforms and deregulation

• Indonesia, Thailand, and South Korea accepted the IMF loans, while Malaysia resorted to temporary capital controls in 1998

• The crisis-ridden economies recovered to the pre-crisis level in late 1999
The Asian financial crisis in 1997~98

<table>
<thead>
<tr>
<th>Country</th>
<th>Average in 1996 (a)</th>
<th>Peak Level (a)</th>
<th>Date of 1997 Peak</th>
<th>Change in US Dollar Exchange Rate Jun 97 to Sep 98 (b)</th>
<th>Change in Real Exchange Rate Jun 97 to Sep 98 (b)</th>
<th>Move in Stock Market During 1997</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>5.5%</td>
<td>25.0%</td>
<td>October</td>
<td>0.0%</td>
<td>16.1%</td>
<td>-18.7%</td>
</tr>
<tr>
<td>Indonesia</td>
<td>13.8%</td>
<td>27.7%</td>
<td>October</td>
<td>-77.7%</td>
<td>-56.3%</td>
<td>-37.0%</td>
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<tr>
<td>Malaysia</td>
<td>7.3%</td>
<td>8.8%</td>
<td>November</td>
<td>-39.8%</td>
<td>-27.2%</td>
<td>-52.2%</td>
</tr>
<tr>
<td>Philippines</td>
<td>11.7%</td>
<td>85.0%</td>
<td>October</td>
<td>-38.3%</td>
<td>-26.0%</td>
<td>-40.3%</td>
</tr>
<tr>
<td>Singapore</td>
<td>3.0%</td>
<td>10.3%</td>
<td>December</td>
<td>-17.6%</td>
<td>-2.7%</td>
<td>-31.7%</td>
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<tr>
<td>South Korea</td>
<td>13.3%</td>
<td>25.0%</td>
<td>October</td>
<td>-33.8%</td>
<td>-19.8%</td>
<td>-42.6%</td>
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<tr>
<td>Taiwan</td>
<td>5.5%</td>
<td>9.8%</td>
<td>October</td>
<td>-19.4%</td>
<td>-12.4%</td>
<td>9.3%</td>
</tr>
<tr>
<td>Thailand</td>
<td>13.0%</td>
<td>26.0%</td>
<td>December</td>
<td>-36.7%</td>
<td>-19.1%</td>
<td>-55.2%</td>
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Source: Karunatilleka 1999.
The Asian financial crisis in 1997~98
Crisis diagnosis and post-crisis responses

• What caused the Asian Financial Crisis?
  • The development model of East Asian economies
    • Excessive government intervention
    • Crony (i.e., corrupted) government-business relationship
  • A wrong path of financial deregulation
    • A proper sequence of financial liberalization
  • Risk of global financial market
    • Speculative currency attack
    • Panic (i.e., irrational) market behavior
  • An IMF/US plot to weaken East Asia?
Crisis diagnosis and post-crisis responses

• If the crisis were caused by the Asian development model or by bad planning, the best response should be neoliberal reforms (institutional restructuring, market deregulation)
  • Northeast Asian economies: South Korea, China and Japan
  • Restructuring the relationship between the government and business

• If the crisis were caused by global financial market or exacerbated by IMF conditionality, the best response should be government bailout and a new economic defense mechanism
  • Southeast Asian economies: Thailand, Indonesia and Malaysia
  • The government-local business relationship strengthened
Post-crisis restructuring in Northeast Asia: embracing neoliberal reforms

• In South Korea, the Kim Dae-Jung government adopted sweeping neoliberal reforms to flight against *chaebols*, deregulate the labor market, and welcome foreign investment

• In China, Primer Zhu Rongji implemented wide-ranging financial, SOE and social welfare reforms, restructuring the state-owned banks and enterprises, privatizing small and medium SOEs, and leaving a huge number of workers without jobs and social protection

• In Japan, the Hashimoto government’s financial ‘big-bang’, followed by Koizumi’s extensive pro-market and deregulatory reforms under the slogan of ‘leaving to the private sector what it can do’
Post-crisis restructuring in Southeast Asia: backlash against IMF-led liberal reforms

• In Malaysia, the pro-IMF financial minister Anwar was sacked and imprisoned by Mahathir who then introduced capital controls, fixed the exchange rate, and pushed for the bailout of local business in 1998

• In Indonesia, Suharto resigned in 1998 amid massive corporate failure, student protests and street riots, and the lost confidence by the IMF. The subsequent political democratization and constitutional decentralization process favored local business against foreign investors

• In Thailand, Thaksin-led TRT won the general election in 2001 amid widespread dissatisfaction and antagonism against IMF and foreign capitals, based on an electoral platform favoring the interests of the local business and the rural poor
Towards an Asian model of developmental state

• Despite the policy and structural differences, the state’s active roles in economic management contributed to the rapid growth in East Asia

• A model of Asian developmental state
  • Economic growth as a state priority
  • Government-business coordination
  • Regional diffusion of the developmental policies and practice

• However, challenges ahead
  • Criticisms against the state’s direct intervention
  • Major economies adopted liberal reforms and reoriented state policies