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Development and Change, Forum 2018, March 2018

Debate

The Developmental State: Dead or Alive?

Robert H. Wade

ABSTRACT

Before the 1980s, the mainstream Western prescription for developing countries to catch up with the West involved the state taking a leading role in governing the market. In the 1980s, this shifted to assigning the state a framework-providing role in a largely deregulated and maximally open economy. Also in the 1980s, it became apparent that some East Asian capitalist economies were growing so fast that they would become 'developed' in the foreseeable future, marking them out as completely exceptional. Mainstream economists explained their success as the result of following the Western prescription, while other scholars attributed this rapid growth to 'the developmental state'. This essay compares these two explanations of successful economic development, concluding in favour of the latter — with respect to the catch-up decades. But what happened subsequently? Several scholars who accept the key role of the developmental state in the early period of fast industrialization in East Asia now argue that South Korea, Taiwan and Singapore have transformed from developmental to close-to-neoliberal states. This essay argues that the erstwhile East Asian developmental states have indeed changed, but they have not transformed into neoliberal states. Rather they have adapted and evolved, but still undertake market-steering, 'societal mission' roles well beyond neoliberal limits. The essay also suggests how other developing countries can learn lessons from their experience.

[first, unnumbered footnote]

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'I beg your pardon, I never promised you a rose garden' (popular song by Joe South)

THE ASCENT OF THE GLOBALIZATION MINDSET

Since the 1980s it has been commonplace to say that the grab bag of forces known as 'globalization' has curbed the 'policy space' of all states, to claim that there is really only one broadly effective institutional and policy recipe for fast economic growth, known as the Washington Consensus, which could equally be called the Western Consensus. The state should provide — or ensure the private provision of — a range of public goods that are not in the interests of private profit-seeking companies to provide on their own, which include physical infrastructure, free markets, macroeconomic stability, and an institutional framework for the rule of law. The state should not, except occasionally at the margins, try to steer resource allocation, impart directional thrust. Whether in advanced or developing economies, the allocation of resources should be left mostly to the interaction of consumers and private producers.

The underlying justification for this is the claim that competition between private economic agents is the only legitimate, reliably welfare-enhancing organizing principle for human activity. It stimulates creative and entrepreneurial abilities, and yields an efficient allocation of resources. State 'intervention' should be very limited because the societal costs — including loss of the most prized value, individual liberty — are likely to be higher than the societal gains, even where 'market failures' can be identified. The larger the scale, the better: if competition is on a global scale, each country's gain will be greater. Any form of protection or subsidy is likely to be a drag on efficiency, like throwing rocks in your own harbour.

The source of this sanctification of 'the market' was Friedrich Hayek, who experienced in 1936 what he described as a 'sudden illumination': 'How can the combination of fragments of knowledge existing in different minds bring about results which, if they were to be brought about deliberately, would require a knowledge on the part of the directing mind which no

single person can possess?' (quoted in Metcalf, 2017). Or as Mrs Thatcher used to say, 'You will always spend the pound in your pocket better than the state will'.

These statements reflect a mindset often called 'neoliberal'. It prioritizes 'exit' over 'loyalty', meaning 'keep options open', 'minimize commitment', so that resources can be quickly moved to more profitable alternatives. *Le Monde* once called it 'cette attitude tres Anglo-Saxon — le "wait and see"'. Hayek used the word with positive connotations, as did his followers, but by the 1980s those followers were describing themselves as neoclassicals or just liberals, and 'neoliberal' came to be used mostly by critics. Here I use it in a more analytical sense, to denote a certain cognitive and normative mindset.

Neoliberal ideas have become immensely powerful in shaping the content of institutional and policy 'reform'. The inter-state organizations directly concerned with economic development in developing countries — the World Bank, International Monetary Fund (IMF), the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD), most parts of the United Nation's family of development-related agencies, and several regional development banks — have all helped to boost the power of neoliberal ideas since the 1980s (Krueger, 1990). So too have Western academic economists and business leaders. Here are a few examples of the neoliberal mindset.

A *New York Times* journalist covering the World Economic Forum meeting in 2002 wrote that business executives and government leaders in attendance believed that, 'a nation that opens its economy and keeps government's role to a minimum invariably experiences more rapid economic growth and rising incomes' (Uchitelle, 2002). Percy Barnevik, whilst CEO of the Swedish-Swiss multinational Asea Brown Boveri (ABB), said: 'I would define globalization as the freedom of my group to invest where and as long as it wishes, to produce what it wishes, by buying and selling wherever it wishes … while putting up with as little labor laws and social convention constraints as possible' (quoted in Gelinas, 2003: 21). Bernard Arnault, CEO of French luxury group LVMH and 10th richest person on earth in 2000, said: 'Businesses, especially international ones, have ever greater resources, and in Europe they have acquired the ability to compete with states …. Politicians' real impact on the economic life of a country is more and more limited. Fortunately' (quoted in Halimi, 2013). In 1988, James Riedel, then professor of international economics at The Johns

Hopkins University, explained the exceptional development success of East Asian countries thus:

> The policy lessons that derive from the experiences of the East Asian countries are simple and clear-cut, and for that reason are all too readily ignored or dismissed …. [The lessons are that] neo-classical economic principles are alive and well, and working particularly effectively in the East Asian countries. *Once public goods are provided for and the most obvious distortions corrected, markets seem to do the job of allocating resources reasonably well, and certainly better than centralized decision-making*. That is evident in East Asia, and in most other parts of the developing and industrial world, and is after all the main tenet of neo-classical economics. (Riedel 1988: 38, emphasis added; see further, Wade, 1992a).

A more subtle version of the argument appeared in the World Bank's high-profile *East Asian Miracle* book, published in 1993. It took eight 'high-performing Asian economies' as its subject: Japan, the three first-generation newly industrialized economies of South Korea, Taiwan and Singapore, and three second-generation Southeast Asian economies of Thailand, Malaysia and Indonesia, plus Hong Kong. The book argued that the states had made important contributions to the fast growth of these countries by ensuring 'the fundamentals': low inflation and competitive exchange rates; human capital; effective and secure financial systems; low price distortions; foreign technology; and low bias against agriculture. But 'strategic' interventions — promoting specific industries — 'generally did not work' (World Bank, 1993: 354). The take-away message, said the World Bank, was: '*openness to international trade, based on largely neutral incentives, was the critical factor in East Asia's rapid growth*' (ibid.: 292, emphasis added).

The origin of the *East Asian Miracle* study lies in the criticisms made by top World Bank officials of Japan's aid programmes in Southeast Asia, in which targeted and subsidized credit was an important component. The Japanese Ministry of Finance (MOF), which helped to design and operate the credit programmes, took offence at the Bank's claim that directed credit only distorted financial markets (not least because MOF considered that its directed credit programmes during the post-war decades in Japan had been its major contribution to the 'Japanese miracle'). MOF more or less forced the reluctant Bank to undertake a study of Northeast and Southeast Asia, to identify the causes of the larger region's relative success. The Bank could not bat away Japan's request, because Japan was by then the number two

shareholder at the Bank and MOF put US$ 1.2 million on the table to finance the study. After the study was published, senior Bank officials informed the world that the Bank now understood sufficiently the causes of fast economic development in East and Southeast Asia, would not undertake more research on the question, and would concentrate on spreading the message about the importance of liberalizing markets and integrating into the world economy to governments elsewhere, in Latin America and especially in Africa.[1]

So the World Bank managed to show that the East and Southeast Asian success stories confirmed the recipe it had been urging on all developing countries since the early 1980s, later described as the Washington Consensus, especially the priority of trade liberalization. Indeed, the World Bank's Structural Adjustment Loans over the 1980s carried more trade liberalization conditions than those in any other policy domain. The Bank treated trade liberalization as the queen of policies, not just one among many, claiming that free trade policy would limit the amount of damage from other government interventions in the market (World Bank, 1989).

Fast forward to 2008, when Justin Yifu Lin was appointed Chief Economist and Senior Vice President at the World Bank. He was Chinese, with a PhD in Economics from the University of Chicago, and the first ever Chief Economist from a non-G7 country (most have been American or British). He tried to end the earlier banishment of the phrase 'industrial policy' from World Bank vocabulary, advancing the idea that some selective promotion of certain industries could be appropriate provided that the targeted industries were *within* the economy's existing comparative advantage and their promotion was not a bold attempt to accelerate the upgrading of comparative advantage by creating a new set of higher value-added industries (or segments of regional production chains). He approached several regional vice presidents within the World Bank with the idea that they might organize a few pilot projects. The general response was negative. One of the senior economists in Lin's own vice presidency declared to me, with a dismissive wave of the hand, 'For every Korea there are a hundred failures. Who would you put your money on?' (personal communication, 2010). Lin himself admits that during his time as Chief Economist, less than 10 per cent of World Bank economists were sympathetic to his arguments (personal communication, 2010)

[1] For a rich discussion of the *East Asian Miracle* book, with commentators from Japan, Asia, the UK and USA, see OECF (1995); see also Rodrik (1994); Wade (1995, 1996).

A few pilots did go ahead, under the name 'Competitive Industries Program'. But Lin's successor in the research complex appointed a Director of Development Policy who, according to a colleague, 'strongly opposes any form of active government strategy' (personal communication, July 2014). And in the operations complex, the newly appointed Senior Director most relevant to continuing the Competitive Industries Program closed it down on grounds that 'she understands industrial policy only as the failed import-substitution policies implemented in Latin America in the 1960s' (personal communication, July 2014). Post-Lin, the Bank hardly engaged with industrial policy.

In short, the mainstream understanding of the causes of fast and sustained growth in East Asia emphasizes that the governments did not 'distort' markets with excessive 'interventions', and that the governments did correct some market failures (including by supplying a range of public goods, including 'rule of law'). In this way governments 'got the prices right', meaning that they let domestic prices align with international prices as they cut back on trade protection and domestic subsidies over time. The profit-oriented decisions of investors and producers made the production structure evolve in line with changing comparative advantage as the economy's average income grew and its endowments expanded.

This interpretation makes East Asian capitalist success a ringing validation of neoliberalism's answer to the great Adam Smith question, of how the capitalist economy generates human well-being. The key to success is resource allocation through markets, which self-adjust largely through price competition. The underlying assumption is that *each unit of additional GDP has the same impact on longer-run growth as any other, regardless of the sector from which it comes*; so there is no need for state steerage of production towards sectors whose output has a bigger impact on longer-run growth.[2] This ideology was already ascending in the West by the late 1970s, and projected into developing countries (DCs) over the 1980s (Wade, 2003, 2015).

This essay, which concludes the Forum 2018 Debate on 'Rentier Capitalism and Economic Development', compares this mainstream economics explanation of fast industrialization and 'catch-up' of a number of states in East Asia with the 'developmental state' argument. The

[2] For a non-polemical critique of neoliberal development economics, see Thirlwall and Pacheco-Lopez (2017).

sections that follow focus on different aspects of the exceptional economic development of South Korea, Taiwan and Singapore, and reach the conclusion that the developmental state — although it has adapted and evolved — is far from dead. The final section suggests some lessons that other developing countries might learn from the experience of these three states.

EXPLAINING THE EAST ASIAN CATCH-UP STORIES

Very few non-Western countries have become developed over the past two centuries. Even extending the boundaries of 'non-Western', 'country' and 'developed', the list is less than 10 — including Japan, Russia, Taiwan, South Korea, Hong Kong, Singapore and Israel. The ascent of all but the first two dates from after World War II. The main long-term growth pattern in the world economy has been: 'divergence, big time' (Pritchett, 1997). A World Bank study (2013) identifies 101 countries as 'middle-income' in 1960, of which only 13 had reached 'high-income' almost 50 years later, by 2008.[3] This very low proportion — especially when islands and oil fields are taken out — gives substance to the metaphors of the 'glass ceiling' and the 'middle-income trap' in the world economy (Wade, 2016).

The 'Asian tigers' — Taiwan, South Korea, Hong Kong, Singapore — are held up as the champion developers of the post-war era, all the more so because of their starting point in the 1950s, with few natural resources, high poverty rates, and a tumultuous emergence as sovereign states (Hong Kong aside). Table 1 provides a snapshot of their economic development trajectory. Cases of a country growing continuously at 6 per cent per year or higher for more than 15 years are uncommon. Until 2010, Taiwan held the world record at 32 years (1962–94), followed by South Korea at 29 years (1962–91). In 2010, China broke the world record; it had grown continuously at more than 6 per cent for 33 years (Pritchett and Summers, 2014).

[Typesetter, please insert Table 1 about here]

[3] As of mid-2015, the Bank defined low-income economies as those with a Gross National Income per capita of US$ 1,045 or less in 2014; middle-income economies as those with more than US$ 1,045 but less than US$ 12,736; high-income economies as those with US$ 12,736 or more. It separated lower-middle-income and upper-middle-income economies at US$ 4,125 (http://data.worldbank.org/news/new-country-classifications-2015). The 13 economies which rose to high-income were Equatorial Guinea, Greece, Hong Kong, Ireland, Israel, Japan, Mauritius, Portugal, Puerto Rico, Republic of Korea, Singapore, Spain and Taiwan. See also Cherif and Hasanov (2015).

Mainstream Economics' Lessons from the East Asian Exceptions

The rise of the East Asian three[4] provoked a debate about the reasons for their exceptional success. As suggested earlier, most economists and the main Western-controlled multilateral development organizations (including the World Bank, the IMF, the OECD and its Development Centre), focused on liberalization of markets, including trade in goods and services, investment and finance — including opening to the international economy. Producers and consumers in those territories became more and more able to take advantage of the opportunities for profit and consumer satisfaction available in the wider economic space. So the rise of the East Asian capitalist cases confirmed the truth of globalization theory and the Washington Consensus policy recipe. If other developing countries also liberalized and integrated steadily into the international economy, they too could catch up, especially with all the opportunities available in global value chains since the 1990s. The world economy is, by assumption, an open system, with no segmentations or structural obstacles to the rise of developing countries.

The Developmental State 'Theory' of East Asia's Success

The mainstream economics explanation for East Asia's success is so short-sighted as to recall Alice's exchange with the King in *Through the Looking Glass*:

> 'I see nobody on the road', said Alice.
>
> 'I only wish I had such eyes', the King remarked in a fretful tone. To be able to see Nobody! And at that distance too! Why, it is as much as I can do to see real people, by this light'.[5]

We now have a sizable body of literature about the developmental state in East Asia (a phrase coined by Chalmers Johnson in his 1982 study of Japan's rise; see also Haggard, forthcoming

[4] This article keeps Hong Kong to one side, because it was a British colony for 150 years from 1841 to 1997, except for the Japanese war-time occupation. Hong Kong surfed to prosperity on the back of its roles as entrepot port for giant China and the East Asian centre for British banks, all under the protection of the British government. Singapore was a British colony for 144 years up to 1963, when it joined the Malaysian Federation. It became a sovereign state in 1965 when it left the federation; Singapore has thus had fifty years as a sovereign state.

[5] Lewis Carroll, *Alice through the Looking Glass*, Chapter 7.

2018). Emanating mainly from political scientists, political economists and historians, this literature tends to make little direct engagement with mainstream economics (and vice versa). Both sides claim truth, but a detached observer must conclude that neither side has produced 'knock-out evidence' (Rodrik, 2012). It is difficult to find 'exogenous' sources of variation from which to test causality 'rigorously' (an exogenous source of variation might be an asteroid impact or the election of President Trump).

The developmental state theory of capitalist East Asia's success starts from the fact that these economies were able to develop mostly indigenously owned firms across a broad range of major global industries, capable of acting as first-tier suppliers to multinational corporations (MNCs) and even competing head-to-head with them. The range included chemicals, petrochemicals, electronics, steel, shipbuilding, cars or car parts. The question is how they did so, when the great majority did not. The theory focuses on the syndrome of politics, ideas, institutional arrangements and policies of the three main cases during their decades of super-fast industrialization after World War II (Thurbon, 2014, 2016). Implicitly or explicitly the theory compares the East Asian cases to the neoliberal model, or Washington Consensus (Weiss, 1998).

At the *political and ideas level*, the neoliberal model assumes an elite consensus about the efficiency and growth advantages of more or less free markets, including high integration into the world economy. In contrast, the developmental state model (inferred from the East Asian cases) assumes at the political level an elite consensus on the following:

1. High priority given to achieving high and sustained economic growth rates, so as to catch up with developed countries 'quickly' (within a few decades);
2. Very high rates of investment to GDP so as to achieve rapid movement of the production structure into higher productivity activities;
3. The need for the state to coordinate the catch-up strategy and promote some sectors and functions ahead of others, whether through public enterprises or through steering private actors into sectors they would otherwise not enter;
4. The need for the state to curb the growth of consumption by the urban labour force and farmers, so as to free up more resources for investment;
5. The need for the state to strenuously promote exports, so that the high investment can be profitable despite restrained growth of consumption at home; but at the same time, state industrial policy must target the feasible replacement of imports and concentrate

foreign exchange on imports of capital goods, intermediate goods and raw materials (not consumer goods) by means of a managed trade policy, not free trade.

Underpinning this elite consensus is recognition that investment resources are very scarce and must be carefully husbanded. The elite has no commitment to the idea that 'free markets' or high integration into the world economy will produce the optimal production structure over time.

In the East Asian cases, the content of the optimal production structure to be aimed at was influenced by popular metaphors of economic development, like descending a river, or flying in a V-shaped formation of geese. Officials in South Korea and Taiwan saw their economies descending the same stretch of river, or flying in the same V-formation, as Japan some 10 to 20 years before. They could look to Japan's past production structure for a *tangible* indication of what they should be developing (qualified, of course, by knowledge of present-day developments in technology and markets, especially in Japan and the USA). The neoliberal model has no equivalent, for the idea of such a compass contradicts the basic point of Hayek's 'sudden illumination', quoted earlier. These ideas about a national development project exemplify what Elizabeth Thurbon (2016) describes as 'the developmental mindset'.

Next, *institutional arrangements*. The neoliberal model emphasizes the need for checks and balances between the various government ministries concerned with economic policy, so at central government level authority is horizontally decentralized, with no focal point to ensure cooperation between ministries in line with an economy-wide investment strategy. Also, the model emphasizes arms-length relations between government agencies and business, to avoid the ever-present danger of business capturing government, given the propensity for government officials to behave 'opportunistically'. And it emphasizes the need for an independent central bank with price stability as its number one objective, and for the rest of the banking sector to take the form of private commercial banks.

In the developmental state, bureaucratic power is highly centralized — meaning power is concentrated horizontally and vertically (one or a few ministries are dominant, such as MOF and MITI — the Ministry of International Trade and Industry — in post-war Japan, and power is concentrated at the top of ministries), in sharp contrast to, say, Greece (Wade, 2012). Second, the central bank is not independent of the top political leadership (in Taiwan the governor had senior cabinet rank), and the rest of the banking sector includes a large

presence of state-owned banks, through which strategically designated industries and firms can be served. Capital movements across borders are closely controlled. In 1999 the governor of Taiwan's central bank was horrified to learn that Taiwan's team negotiating WTO membership was promising to give up capital controls; his response was to recruit staff with PhDs in financial engineering to build up covert controls deep within the bowels of the central bank (personal communication, 1999).

Third, the developmental state gains high 'capacity' from institutional arrangements of 'embedded autonomy', to use Peter Evans' apparently oxymoronic phrase (Evans, 1995; Woo, 1991). This means that the state and its officials have a close working relationship with capitalists, but also the capacity to discipline capitalists and capital. They have the autonomy needed to formulate and implement a strategic vision for the economy's future growth and to discipline the owners and managers of capital in line with that vision; while they also maintain close enough relationships with these owners and managers of capital to get information feedback and corporate buy-in to the national project.

Embedded autonomy is a necessary but not sufficient condition for an effective developmental state. The Bank of England, as Iain Pirie points out (2017), has long had high autonomy (and was given full operational responsibility for monetary policy in 1998), while it has also long been 'embedded' in relationships with the private sector. It has used that position to promote the exposure of companies in the UK to global competitive pressures, not to play a role in shaping the production structure (beyond boosting London as a global financial centre). No one would accuse the Bank of England of being a pillar of the developmental state. It has used its embedded autonomy to champion neoliberal policies.

We should also note that the 'embedded' part of embedded autonomy did not include much input from labour unions, especially in South Korea and Taiwan before the late 1980s, when they both transitioned from one-party or military rule to a form of democracy. Labour repression, political marginalization of the working class, was part of the model, to keep down labour costs, prevent consumption demand from eating into the cycle of investment-profits-reinvestment, and keep the state–business vision of future transformation on track (Deyo, 1987; Kohli, 2004).

Next, at *the policy level*, the neoliberal state emphasizes: (a) low inflation, not full employment; (b) shareholder value maximization as the top corporate objective; (c) maximum flexibility of labour markets, minimally constrained by trade unions; and of course, (d) globalization, or high integration between the national and international economy in terms of trade, investment and finance. Since the rise of global value chains (GVCs), the key route to economic development is to integrate into GVCs and accept the private governance of the lead firms (mostly Western, Japanese or, latterly, Chinese) in each GVC. Competition will keep the private governance aligned with social interest.

The developmental state, on the other hand, uses its powers to push production into sectors and products with increasing returns and external economies, keeping a large measure of ownership in national hands and looking all the time for opportunities to replace sophisticated imports with domestic production (in priority sectors). It deploys a wide range of instruments, including directed credit, fiscal investment incentives (such as tax rebates on production of products currently on the country's technology frontier), trade protection (combined with a tariff-rebate system so that producers can get tariff-free import of inputs which go into their exports while they pay the tariffs on what they sell on the domestic market), and hard bargaining with multinationals intending to make foreign direct investments within the national territory (such as local content requirements on a proposed ethylene plant or chip plant) (Enos and Park, 1988; Wade, 1990/2004, 1991). Richard Luedde-Neurath (1986) documents the elaborate covert trade controls used by the Korean government at the same time as it boasted to the world of its waves of trade liberalization (see also Wade, 1993, for Korea and Taiwan).

In contrast to many other governments which used similar instruments from time to time, the developmental states in East Asia normally imposed *performance conditions* of one kind or another to accompany state assistance. The conditions might relate to closing the price and quality gap between imports and domestic substitutes, or to pushing out the technological frontiers of domestic production (for example, tax incentives for the first few producers to make electrical transformers above a certain capacity) (Amsden, 2001).

Trade protection did not remove international competitive pressure on producers. It *buffered* producers from international competitive pressure until such time as the producers succeeded in (almost) matching the price and quality of competing imports, or failed to do so (Wade,

1990/2004). In either case, the promotion assistance was withdrawn and redirected elsewhere. The effects were very different to protection in many other DCs (and New Zealand before the 1984 big bang liberalization), where it was given without performance conditions. So, year after year, the unconditionally protected Indian automobile industry produced Ambassador limousines based on 1950s' British automobile technology, until a few foreign car makers were allowed to set up production during the 1980s.

We can sum up by recalling the key initiating conditions of the East Asian developmental state: low average income, few natural resources, acute shortage of capital, and an elite consensus around the *idea* of catch-up, which required very high rates of investment and re-investment driven by the aim of diversifying production (not specializing) in the direction of the higher-tech industries of Japan and the West. Hence the imperative of:

1. allocating scarce capital so as to maximize economic transformation (especially diversification and upgrading in industry);
2. operating within constraints of a capitalist system in which most resource allocation occurred through the market rather than through a central plan;
3. obtaining large resource transfers from abroad, so as to raise the domestic rate of investment beyond what it otherwise could be; and
4. building industrial science and technology institutes, networked into private firms, starting in Japan in the 1950s and followed by Taiwan and Korea in the 1960s.

These efforts were complemented by mechanisms to restrain non-productive wealth accumulation and luxury consumption. In Taiwan, for example, it was understood (as of the early 1980s) that a family could own and rent out three or four apartments without attracting close inspection by the tax authorities, whereas a family clearly investing in rental properties would not be spared; meanwhile, a family building up businesses, especially ones oriented to exports, would be treated with more latitude, exports being a focal point of government–business relations more generally. In class terms, the state dominated in state–capital relations, and the state helped capital to dominate in capital–labour relations (Deyo, 1987; Wade, 1990, 1990/2004).

The Arrangement of Power in Northeast Asia

What brought about the configuration of politics, ideas, institutions and policies in the East Asian three that we call the developmental state? What motivated key national actors to cooperate with each other to make a ‘growth coalition’ and agree to promote very high investment and a national development plan to upgrade the production structure? What was the coalitional glue? Remember that the national development project entailed not just policies on money supply, exchange rate, export subsidies, import protection and tax exemptions, which could be decided by small groups of insulated technocrats, but also policies on health, education, training and transport, which needed far-flung bureaucracies and impacted directly on people’s lives across the whole society. How was discipline maintained over the interventions, in line with a national development project, as distinct from feeding the support mechanisms (such as patronage networks) to keep a particular group in power regardless of cost to the national development project? The literature on the developmental state pays surprisingly little attention to questions of this kind (Doner and Schneider, 2016).[6]

The arrangements of power — or ‘political settlements’ — of the East Asian developmental states had several features in common. The first was centralization of power during the fast-industrialization decades. Taiwan was a repressive one-party state until the late 1980s; Korea was a repressive military dictatorship until the late 1980s. Singapore has long been a fairly repressive, almost-one-party state. Hong Kong was ruled mostly from London until the late 1990s. Even Japan has come close to one-party rule for most of the period since 1955. The second was that the post-war rulers faced little opposition from landed elites. Japan, Taiwan and Korea carried out expropriative land reforms. This left the post-war incumbent elites freer to direct resources to the new and more productive economic sectors. In contrast, the Philippines did not carry out significant reform, and the landlord–government nexus continued to wield political and economic power and to reinforce Philippine’s dependence on commodity production.

The third shared feature was the dense penetration of the societies by the state, with organizations designed to incorporate citizens from the top down, and thereby minimize political opposition. In pre-democratic Taiwan, for example, every industry with more than

[6] Wade (1982) gives a detailed account of the Korean bureaucracy at work in the capillaries of the state system; Wade (1985) examines India’s bureaucracy and its corruption system; Wade (1992b) gives a Korea–India comparison of bureaucratic organization.

five firms had to form an industry association, with an elected committee (so there was a Taiwan Feather Exporters Association); but the Secretary was appointed by the state, and acted as the intermediary, including to the security services. In Korea, the Saemaul Undong (SU) Movement established a committee in every village, which could decide how SU resources were to be used (for example, to construct an access road, a bridge, a school). At the same time, SU — run by a giant hierarchy parallel to the state and headquartered in the Blue House, the president's office — was a mechanism for identifying village leaders and bringing them up to the SU School in Seoul for 'training' (including in patriotism). All three states combined vigorous 'socialization' in patriotism and loyalty to the government with effective repression of dissidents. Economic growth was fast enough, and income and wealth inequality low enough, to ensure that just about everyone experienced quickly rising living conditions. This was the formula for producing 'consent' to the rulers. The highly controlled incorporation of citizens into the structure and ethos of state power and the national development project helped to generate 'social capital' and fervent nationalism over decades, helped by the looming presence of North Korea and mainland China (Wade, 1982).

By the time these countries began to democratize in the 1980s they had experienced decades of fast growth and tightly disciplined citizen incorporation in the state. China today is following their example: tight top-down political control, vigorous socialization in patriotism, savage repression of dissidents, coupled with fast transformation of production and rural-to-urban living. The latter entails considerable liberalization of markets, which puts a strain on existing political settlements or 'division of spoils' — strains to be contained by top-down control via state, law and Communist Party, to the point where all religions must regard the Communist Party as their highest authority.

The 'Luck' of Location and Timing

The Northeast Asian states were 'lucky' in a number of respects related to location and timing. First, they faced communist enemy states close by, which acted as 'glue' for elite solidarity and popular legitimacy. The constant fear of invasion and domestic insurrection which might be exploited by foreign enemies helped to keep the rulers, politicians and officials disciplined in line with national prosperity and national security objectives. For the same reasons, they received huge amounts of US financial, technical and military support up

to the mid-1960s, and continuing large-scale military support after that. In the case of Taiwan, US financial transfers averaged about US$ 600 million a year from 1951 to 1965 (in 2016 dollars), the biggest US aid transfers per capita in the world at that time. The US civilian and military aid officials were particularly attentive to ensuring the appropriate use of the resources they transferred to Taiwan, well aware of the history of mega-corruption in the Nationalist government during its decades of rule on the Chinese mainland before the retreat to Taiwan in 1949 in the face of the communist victory. US resources went directly to firms in the fertilizer, shipping, cement, aluminium, paper, glass, sugar, chemical, synthetic fibre and pharmaceutical industries. US officials helped draw up regulations for investment, export-processing zones and the like. They consistently opposed the many senior people in the Nationalist government committed to establishing new enterprises as *public* rather than private enterprises. They put their weight behind those wanting strong state leadership of a largely private sector economy. The former US colony of the Philippines, by contrast, received much less US support, because it was not on the front line of the emerging US 'sphere of influence' in the western Pacific, not part of the 'containment of communism' strategy. And US officials here remained relaxed as aid resources fed into existing landlord-dominated patronage and corruption networks, unlike their counterparts in East Asia (Lee, 2017).

Second, having few natural resources, the Northeast Asian countries escaped the 'natural resource curse'. Many natural-resource exporting DCs have had overvalued exchange rates relative to the exchange rate at which manufactures could be competitive. Their governments are often based on control of natural resource enclaves, supported by multinational corporations and Western governments; in such cases the idea of a national development project is likely to remain in the realm of rhetoric. Mineral-rich DR Congo is a dramatic case in point. It had about 112,000 km of paved roads in 1949. In 2004 it had about 1,000 km, mostly connecting mines and ports (Butcher, 2007: 139).

Third, the Northeast Asian economies developed manufacturing well before China, Vietnam, Indonesia and other populous, low-cost countries almost closed off entry into labour-intensive, low-wage manufacturing. Fourth, they practised 'state intervention' at a time when state-owned banks, trade protection, targeted subsidies, price controls and 'getting prices wrong' were still accepted in the West as legitimate instruments of national development, before the 'gestalt shift' of the neoliberal revolution, the formation of the WTO and the

proliferation of Western-dominated ‘free trade agreements’ and ‘bilateral investment treaties’. Fifth, they built up their industrial base before the ‘global political awakening’ led to widespread demands for political participation in national politics. It was easier then for state leaders to implement effective industrial policy and market restrictions (for instance on access to foreign currency) than it would be today.

Two broader points about the US strategy are important. First, in the US vision, Japan was to be the core of the Northeast Asian regional economy, as before World War II, with Taiwan and South Korea as semi-peripheral, lower-cost, offshore industrial sites, and all three were to receive privileged access to the US market. By the time that a small number of retailers (for example, Walmart) began to sweep away mom-and-pop outlets in the USA and search for bulk suppliers in low-cost markets, East Asian firms were the obvious ones to turn to. The Philippines and other parts of Southeast Asia were integrated into the regional economy as exporters of cheap commodities to the industrializing economies further north. This division of labour would allow commerce between countries in the regional economy and those in the nearby communist bloc to be minimized as part of the containment strategy (Lee, 2017).

Second, high levels of US support enabled the East Asian countries to run sustained external payments deficits during their stage of fast industrialization and urbanization — deficits covered by US assistance. Even as they used substantial and strategic levels of protection to foster import replacement, they sucked in huge volumes of imports *in selected sectors*. In contrast, most DCs, lacking large-scale external assistance, could not sustain the external payments deficits that would be necessary for fast industrialization and urbanization — unless financed by loans from the multilateral development banks, which since the 1980s, have carried mostly neoliberal conditionalities, unlike US conditions in its assistance in East Asia.

Economic Effects of the Developmental State

Needless to say, the effects of the East Asian developmental states’ ‘interventions’ in markets are controversial. The prevailing view among Western development economists is that the effects were either insignificant or net harmful relative to what would have occurred with a state role close to the neoliberal model (as in the *East Asian Miracle* volume discussed

above). Here I limit the discussion to two points: observed investment/GDP ratios; and a recent study of the effects of South Korea's Heavy and Chemical Industries drive.

The pursuit of high rates of investment was a key objective of the East Asian developmental state. The following figures illustrate that the goal was amply achieved. Taiwan's ratio of gross domestic investment to GDP jumped from 14 per cent in 1954, to 21 per cent in 1964, and to about 40 per cent a decade later in 1974. Korea's jumped from 10 per cent in 1960 to 36 per cent in the late 1970s, at the height of the Heavy and Chemical Industries drive; then it fell slightly, before rising to 39 per cent between 1991 and 1996. By way of comparison, the UK figure for 1990 was 19 per cent, the US figure 17 per cent (Pirie, 2017). The very high levels of investment in East Asia are also shown in Table 2.[7]

[Typesetter, please insert Table 2 about here]

Nathan Lane (2017) uses detailed input-output analysis to investigate the effects of South Korea's Heavy and Chemical Industries (HCI) drive, whose formal period was 1973 to 1979. The HCI drive was prompted by the security crisis caused by President Nixon's decision around 1970 to withdraw US troops from Asia, leaving South Korea exposed to North Korean attack. It was formally ended when President Park (whose tenure started after the military coup of 1961) was assassinated in 1979. Its aim was to incubate the strategic industries important for military strength and future growth, copied from Japan's earlier post-war industrialization drive. The main instruments were state-owned policy banks, capital subsidies, subsidies to imported intermediate inputs, selective trade protection, and arm-twisting.

Lane (2017) reaches three main conclusions. First, during and after the HCI period, targeted industries grew faster in terms of output and productivity than non-targeted industries, relative to the period before 1973; second, these growth differences persisted after major elements of the policy were stopped in 1979; and third, there were strong spillover effects through input-output linkages. Non-targeted sectors which were downstream of targeted sectors and had strong linkages with targeted sectors grew faster than those which had weak linkages with targeted sectors, thanks especially to lower input prices. The evidence for non-

[7] A further contextual point: between 1980 and 2015, the share of fixed investment in global GDP fell from about 20 per cent to under 16 per cent (UNCTAD, 2016).

targeted upstream sectors is more mixed, particularly because they faced higher import competition, intensified by (in some cases) capital subsidies to targeted sectors for their imported intermediate inputs.

Similar studies of the impacts of Japan's and Taiwan's industrial policies have not been carried out (to my knowledge), but there is no reason to suppose their conclusions would be significantly different. The results for South Korea make it difficult to sustain a common mainstream assertion that the East Asian countries — which had about the best economic performance in the world in the post-war decades — would have reached even better performance with less 'government intervention' in markets.

REPORTS OF THE DEATH OF THE DEVELOPMENTAL STATE ARE EXAGGERATED

The full-fledged East Asian developmental states were obviously self-limiting, in the sense that the package of (a) elite consensus around the national development project, (b) bureaucracy of industrial planning, (c) array of industrial steerage instruments, and (d) repression of labour, came out of shared elite conviction of the imperative of very high rates of investment so as to upgrade the production structure quickly, raise mass living conditions to inhibit domestic rebellion, and support a strong military, coupled with knowledge that many domestic firms could not compete 'on a level playing field' with firms in developed countries. As the economies moved into or came close to 'high income' they experienced the problem common to developed countries: they became less able to generate enough profitable investment opportunities to absorb domestic savings (especially given the various policies in place to restrain consumption). Far from a severe shortage of capital, they began to face an abundance. At the same time, the general level of productivity was now high enough for most firms not to need subsidies or protection in order to compete domestically or abroad.

For Iain Pirie, the transition from capital scarcity to capital abundance changes the basic logic: the state is no longer 'developmental'.

> It only makes sense to define a state as developmental if the mobilisation of capital in pursuit of industrial policy is *the* primary [economic] objective of the state. … The allocation of capital and capital–labour relations have been largely marketised in both

> Korea and Taiwan. The essential elements of the neo-liberal project are in place. *The developmental state is dead*. (Pirie, 2017: 34, emphasis added)

In the case of Taiwan, investment to GDP fell from around 32 per cent in 1974–81 to 24 per cent in 1982–88 and to 22 per cent in 2001–12. In Korea, on the other hand, overall investment to GDP even increased through the 1980s and early 1990s, from around 31 per cent in 1976–80, to 35 per cent in 1986–90, and 31 per cent in 1998–2014; but the high rates of investment went with very high capital to output ratios, so the rate of profit was very low until the 2000s.

The East Asian ex-developmental states have moved close to the model of the neoliberal state, says Pirie. They have 'depoliticised' economic governance and substituted fairly comprehensive 'governance by the market'. In particular: (1) the state has withdrawn from the labour–capital relation (withdrawn from negotiations about wages and working conditions), and relied on the 'discipline of the market' — the threat of unemployment and the threat of bankruptcy — to keep labour under capital's control; and (2) the state has withdrawn from the allocation of credit, as seen in the now 'independent' central banks, and in the large majority of lending having no link to the creation of new productive capacity. Taiwan's still mostly state-owned banks lend mostly to *consumers*, and firms invest with equity and bond financing or retained earnings. Korea's big firms are awash with cash reserves and borrow little from banks. So, in both cases, the capital–labour relation and the allocation of capital have been marketized; the state is out.

Other scholars emphasize different mechanisms producing the same erosion (even 'death') of the developmental state, and not just in East Asia. One is the dominance of global value chains in world production. Firms which were earlier guided by the state have detached themselves and married into GVCs under the guidance of lead firms. Another is governments' learning of the hazards of 'picking winners' on the frontier of high-tech industry (Sato, 2013; Wong, 2011; Yeung, 2014).

Certainly the erstwhile developmental states have moved in a neoliberal direction. The move has been all the easier because, as we saw, during their history as developmental states the state resisted moving in a social democratic direction to build up social protections. Today, public welfare is still underdeveloped and legal obstacles block collective action amongst the working class. Public social spending as a share of GDP remains far below the OECD

average, and the share of the labour force in independent trade unions also falls far short of the OECD average. The governments have allowed the share of wages in national income to keep falling — in Taiwan, from 55 per cent in 1995 to as low as 48 per cent in 2011 (Pirie, 2017: 47). Income inequality has steadily risen since the 1980s. All this fits the neoliberal model. One result is that in both Taiwan and Korea the path of a consumption-led growth model supported by rising wages in line with rising productivity is not an option, given these other trends which the governments have not reversed. The growth model relies on rising household debt plus foreign demand — exports — to close the demand gap, and both are sources of vulnerability. Taiwan's current account surplus to GDP is about the same as Germany's, around 8 per cent. Most of the surplus is with China — a dependence China welcomes as a pull towards political union. Korea's current account surplus to GDP has averaged around 3 per cent over the 2000s, most of it with China (ibid.: 51). Both countries have become highly vulnerable to an economic crisis in China, or forms of arm-twisting.

But to conclude that the developmental state is eroded to the point of insignificance is to see with only one eye, for the reason given by Elizabeth Thurbon:

> [E]fforts to distinguish between state types solely by observing policies are fruitless: all states intervene in their economies to support and promote certain kinds of economic activity. *What distinguishes developmental states from others is not the existence of intervention per se but rather the developmental ambition and elite consensus that frames that intervention and the existence of institutional capacities* that help translate ambition into more or less effective policy outcomes. (Thurbon, 2014: 11, emphasis added)

Evidence adduced by Christopher Dent (2007), Lee, Heo and Kim (2014), and Linda Weiss (2003), among others, supports Thurbon's conclusions that the 'developmental mindset' remains a powerful shaper of development strategy in the industrial economy of Korea, and that there is 'little evidence … [of] rising anti-statist opposition'. '[I]ndustry support has evolved in tandem with changing objectives, there is little evidence to suggest that the Korean state has abandoned such practices in science-based industries …. These tasks do not all lend themselves to "top down" coordination. But this does not necessarily make them less developmental' (Thurbon, 2014: 14).

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Much of this leadership takes the form of overarching 'societal missions' driven by a varying mix of economic and national security objectives. Over the past several decades, all three East Asian (capitalist) cases have experienced a dizzying number of organizational restructurings in the pursuit of national innovation objectives. Standing back, one can see, first, a fairly steady movement from efforts to domesticate foreign innovations and deploy them in the domestic economy (mitigating risks for adopters), to managing uncertainties of innovating on the global techno-economic frontier. Second, one can see a zig-zagging path over time, often coinciding with changes of government: from fairly centralized, top-down control (using methods of formulating, legitimating and implementing innovation policies drawn from the principles of the old developmental state), to more decentralized, 'peripheral islands' of innovation agencies (drawing on the approach of paragon states with strong neoliberal traditions, like the US and UK), and back to more central control, drawing on an updated version of the developmental mindset (Karo, forthcoming 2018).

For example, the Korean government launched a big push for 'green growth' in the late 2000s, extending from full-electric vehicles to smart grids and beyond. This was just one thrust of its wider '577' programme — 5 per cent of GDP invested in R&D, with a focus on 7 major areas, to become one of the 7 major science and technology economies in the world. Indeed, Pirie acknowledges of Korea, 'The state's role in promoting collaborative research and managing "competition" goes far beyond what we may expect a "normal" neo-liberal state to play' (Pirie, 2017: 35).

Taiwan's government has boosted R&D capacity for many decades. By the early 1980s it had created the Science and Technology Advisory Group (STAG), composed of a senior cabinet minister, the Minister for Science and Technology, as chair, and seven to ten advisors, all foreign, who met twice a year for a week at a time, backed by a local secretariat. It scrutinized the soundness of proposals for new initiatives in Taiwan, and developments in the rest of the world of relevance to Taiwan. By the mid-1980s the publicly funded Industrial Technology Research Institute (ITRI) had a staff of around 10,000 divided into separate institutes (such as the Electronics Research and Service Organization, ERSO). ITRI in turn instituted multiple networks in public and private enterprise, and made it easy for its scientists to spin-off commercial applications. Alongside ITRI was a secret military counterpart with a staff of roughly 20,000 (Wade, 1990/2004). In 2012, STAG was folded into a more formalized body, the Board of Science and Technology (BOST), presided over by

the Premier and including heads of key agencies, industries, research organizations and academia. All this is part of a drive to combine bottom-up creativity with top-down control, by leading many participatory networks while keeping formulation of priorities and control over concessional innovation finance high up in ministries.

This is very different from the neoliberal model, characterized by elite consensus that free and competitive markets will generate the optimum production structure for a national economy, with publicly funded innovation feeding in from decentralized innovation islands. The East Asian cases retain the capacity — in terms of mindset (ideas and commitment) and in terms of bureaucracy — for the state to impart directional thrust in parts of the economy, well beyond neoliberal principles, while leaving most of the rest untargeted.

Iain Pirie calls them neoliberal states with legacy developmental state qualities, or 'post-developmental states'. But this obscures the continuing developmental mindset driving the state to keep pushing for production transformation, seen as necessary to keep far ahead of communist enemy states nearby and avoid domestic unrest. The developmental state has not so much 'declined' or 'disappeared' in East Asia in favour of the neoliberal state, as Pirie claims. It has 'evolved' in response to changing parameters. In Dent's words, 'while the policy tools and means may have changed, developmental states still preside over various adaptive-cum-transformative economic projects that increasingly involve a partnering with transnationalized capital' (Dent, 2007: 227). Weiss says about Taiwan's Financial Merger and Acquisitions Law, that its developmental intent is to 'promote national firms capable of withstanding competition from foreign firms' (Weiss, 2003: 266). In short, we should talk not of the death of the developmental state in East Asia and rise of the neoliberal or the post-developmental state, but of the transformation of the developmental state from 1.0 to 2.0.

ANTI-DEVELOPMENTAL FORCES IN THE WORLD ECONOMY TODAY

As noted, few non-Western countries have become 'developed' in the past 200 years. Apart from mega China and mini Taiwan (off China's coast), no national economy has grown at more than 6 per cent a year for 30 years or more. Many others have managed 6 per cent or more for a decade or so, only to experience a protracted growth slowdown (Broadberry and Wallis, 2016). Sharp growth slowdowns are more frequent among middle- than either low- or

high-income countries. The world economy seems to contain something analogous to a 'glass ceiling' or 'middle-income trap'.

The development industry which emerged after World War II has, since the 1980s, promised DCs that the strategy for catch-up must centre on integrating the economy more closely to the international economy, and specifically into GVCs, as though upgrading the production structure will then happen 'by itself': 'improve exchange, and production will follow'. The justifications are derived from the exchange-focused (not production-focused) neoliberal paradigm, which presents the international economy as a fully open system, such that where a country ranks on the average income scale is mostly a function of its own resources, location, politics, institutions and policies, as the position of a marathon runner is a function of his or her own fitness.

This conception overlooks forces which tend to perpetuate the hierarchical core–periphery structure of the world economy, which persists in modified form even as populous China rises. One such force is GVCs, widely heralded as providing a gateway for DC manufacturing firms to enter foreign markets — to the point where, as Milberg and Winkler (2013: 238) say, 'the goal of industrial upgrading within GVCs has become nearly synonymous with economic development itself'. Less noticed is that GVCs also erect entry barriers to upgrading and diversification, such as tariff escalation clauses — unless 'at the invitation of' the dominant (mostly Western) firms. A second force is the high concentration of patented knowledge in the hands of Western companies, especially in the sectors of engineering, instruments, chemistry and pharmaceuticals (Pagano, 2014, forthcoming 2017). Both these forces tend to sluice global corporate profits up to companies located in a small number of mostly Western countries, giving those companies significant influence over democratic politics — and over foreign economic policy, including 'free trade agreements' and 'investment treaties'. They reinforce the core–periphery structure (Starrs, 2014). So does a third force, namely, financialization. This refers both to the growth of the FIRE (finance, insurance, real estate) sectors relative to the rest of the economy, and the dominance of 'maximize shareholder value' thinking in corporate decision making, leading to curbs on productive investment (including private R&D) and growth in executive remuneration tied to 'shareholder value' (Lazonick, 2010).

By tightly integrating into the international financial system, middle-income DCs, as a category, make themselves vulnerable. Their domestic asset and credit markets are now heavily populated with foreign investors and financial organizations (raising the economies' external liabilities), thanks to their governments putting few regulations and restrictions on foreign capital inflows, foreign financial establishments in their territory, and residents' access to foreign financial markets as borrowers and investors. Also, their own non-financial corporations have borrowed heavily in international financial markets, further raising the economies' external liabilities. They are thereby exposed to boom–bust cycles in the major advanced countries, the US above all (Akyuz, 2017). Recent research shows how long-run dollar cycles affect economic development in DCs. Dollar appreciation (as during 1981–85, 1995–2002, 2008–09, 2012–15, when the data set ends) is associated with a fall in commodity prices, a fall in DCs' GDP growth, and a rise in the number of DCs experiencing external crises (due to large foreign currency debt and sharp exchange rate depreciations) (Chow et al., 2015; Druck et al., 2015).

Finally in this list of anti-catch-up forces, come the rules of adjusting to payments imbalances. From the beginning of the Bretton Woods architecture in the mid-1940s, the mechanism for curbing countries' external deficits and surpluses put all the adjustment pressure on deficit countries to reduce their deficits, with no symmetrical pressure on surplus countries to reduce their surpluses — a much easier task. Yet developing countries undertaking heavy investment in infrastructure and production capacity should be able to multiply imports of materials and capital goods without raising their deficits to dangerous levels, which would be more feasible if surplus countries imported more and ran smaller surpluses.

The compound of global value chains, knowledge monopoly, financialization, and asymmetric adjustment pressure on deficit countries makes for slow or no long-run convergence upwards of the large majority of DCs towards the average income and productivity of advanced countries (China excepted). The core — the West — depends heavily on rental income accruing from ownership of financial assets, patents, brands and copyrights on software, movies and the like. Western, especially American, firms occupy the commanding heights of GVCs; and on the commanding heights the top positions are occupied by a small number of financial firms, which control the 'real economy' firms through shareholdings and debts, and which drive each GVC towards the goal of shareholder

value maximization, generating unpaid-for costs on the living planet and insecure workforces everywhere (Vitali and Battiston, 2014). In this structure producers in low-income countries (such as Bangladesh and Cambodia) can certainly get a foothold in the entry-level industries like textiles as costs rise in China; but rising into higher value-added activities is much more difficult.

The key policy conclusion is that the government of a middle-income country can substantially raise the probability of the economy sustaining upward momentum through the middle-income range by activism beyond the limits of the Washington Consensus. But the activism is at most a necessary, not sufficient condition; it can easily go wrong. The state giving subsidies and protection against performance conditions, and enforcing those conditions, is altogether more demanding than the state giving subsidies and protection to friends and relatives with no performance conditions, the better to consolidate the clique's grip on power. The latter is the route to large-scale corruption and slow economic development.

SOME GUIDELINES FOR MIDDLE-INCOME COUNTRIES TODAY

Before concluding, this section offers some guidelines or rules of thumb for framing developmental state policies today.

- Be cautious about accepting advice from the World Bank and other Western agencies about industrial policy, such as this statement from the top management of the World Bank to its Board of Executive Directors, in 1991: 'Even if the causes of government failure could be identified and minimized, the report calls for the impossible: fine-tuning an array of trade and industrial interventions to deal with real or perceived market failures is generally not feasible'.[8]

[8] The report about industrial policy was from the Operations Evaluation Department. It concluded, 'The Bank [should] help governments design appropriate industrial policies by collecting, analysing and disseminating information' (OED, 1991: 54). The OED is accountable to the Executive Board, not to management. The management appealed to the Executive Board not to release the report, in a memo which contained the quoted sentence. The Japanese Executive Director insisted the report be released, and it sank without trace in the rest of the Bank. The story illustrates how long and fiercely the Bank has resisted the idea of a state imparting directional thrust to market forces, which reflects the distribution of power in its governance (see Wade, 1996).

- As the key to sustained productivity growth, aim to constantly produce new products, as distinct from relying on learning-by-doing within a stable set of products. Support a relatively small number of sectors at any one time. Concessional loans, or fiscal investment incentives, can be targeted at the production of new products or products already on the country's performance frontier. As more than a few producers become able to meet the standards, adjust the targets upwards (Wade, 1990/2004: Appendix A).
- Think of promoting exports and replacing imports not as alternatives but as complements — 'two wings of the same bird'. Schemes such as duty drawbacks can be used to protect exporters from import protection (Wade, 1991).
- Use protection not to insulate domestic producers from international competitive pressure but to *buffer* them — for example by limiting protection to a certain period within which protected producers must reach close to the price and quality of imported substitutes (Wade, 1993).
- Act strategically when attracting selected portions of GVCs into the national territory. The government 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 example) did not.[9] Today, bargaining hard with incoming Chinese firms is especially important, because their financing is often obscure and they typically wish to transfer little knowledge into the heads of locals (Larmer, 2017).
- Middle-income countries should not rely on foreign direct investment plus low wages. To have a serious prospect of escaping the middle-income trap they have to invest heavily in the domestic capacity to innovate, going beyond imitation and beyond comparative advantage. That means investing in science and engineering, R&D, and harnessing the country's high-skilled diaspora.

[9] 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 the Korean motto, 'We never learn anything twice', a motto I heard during my fieldwork in Korea in 1979 (Wade, 1982).

- Protect the economy against the anti-catch-up effects of financialization. If the opportunities for financial profits (for example, in the FIRE sectors) are not curbed, the state will find it difficult to guide private firms into socially productive activities. Curbing those opportunities means regulating capital flows in and out — which the US government has strongly opposed for its partners in trade deals, and which the IMF and World Bank have also mostly opposed.
- Manage the exchange rate so as to curb the backwash effects on manufacturing of an exchange rate overvalued by commodity exports.
- Pay attention to how the US gets away with telling the rest of the world not to practise industrial policy, while itself implementing an effective industrial policy (more accurately, innovation policy). The US's predominant mode of economic governance is close to neoliberal (but with less insistence on competition and more tolerance of oligopoly), but it has long had a developmental state hidden behind neoliberal culture and institutions. This takes the form of decentralized pilot agencies at federal and state level to promote technological progress in selected sectors which, for political reasons, keep their activities below the radar (Wade, 2017b).[10]

CONCLUSIONS

The glass ceiling in the world economy may have become even stronger in the past two decades, owing to certain global forces which reinforce the core–periphery structure through which DCs have to manoeuvre as they integrate into the world economy: (a) financialization, with the centres of finance still mostly in the West, the US dollar still the dominant international currency, and pressure on DCs to open their capital accounts; (b) global value chains, with market power highly concentrated in firms based mainly in the West plus Japan; (c) intellectual property monopoly, also mainly based in the West; and (d) pressure on deficit countries to curb deficits in the absence of pressure on surplus countries to spend down their surpluses.

[10] For more on prescriptions for institutional and policy reform see Rock (2017); Roll (2014); Wade (2003, 2014, 2016, 2017a).

Overarching all of these, I have emphasized a global force which operates at the level of cognitive and normative ideas backed by powerful Western agency: neoliberal economics and its endorsement of a market-regulatory role of the state, its deep hostility to anything close to a developmental state and to anything called industrial policy. The Anglo-Saxon countries — the US, UK and Germany — have been the global cockpit of neoliberal economics. Not coincidentally the first two have been the world's only two hegemonic states in the past two centuries and the third was for decades an aspiring hegemon. Neoliberal economics applied comprehensively by the core in the periphery is an effective recipe for preserving the core–periphery structure of the world economy — for kicking away the ladder, in Friedrich List's colourful metaphor.

The outstanding cases of non-Western countries which have broken through the glass ceiling have had in common a developmental state implementing industrial transformation strategy over decades, going well beyond the prescriptions of neoliberal economics. Their 'interventions' are steered by the understanding that 'the market', left unguided, is prone to coordination failures and unlikely to exploit the increasing returns to scale and external economies crucial to the growth process. The unguided market will miss much of the value of benefits which a new firm or industry can bestow on others. And it will miss the potentially immiserating effects on poorer countries of free trade, capital movements and migration with rich countries. A developmental state, exercising foresight over the whole economy in a way that no firm normally does, and actively managing the economy's external relations, can steer the structure of production and consumption so as to capture the growth benefits of increasing returns to scale and external economies. But it must do so with performance conditions attached to its assistance, to counter the tendency for firms to press hard for subsidies and protection in order to offset their competitiveness deficit indefinitely. Of course, acting like a developmental state is not easy; but we can be fairly sure that a state which follows neoliberal principles will find it very difficult to sustain growth over many decades, due to strong backwash effects coming from the world economy — effects unseen by the neoliberal advocates quoted earlier.

I pose four questions to end on. First, why are developing country governments willing to sign up to trade and investment agreements with developed country governments which greatly restrict their policy space — including even that allowed by WTO rules? They are giving up policy space often in return for very little (for example, improved access to the

developed country's market for *unprocessed* commodities). Their choice helps to protect the hierarchical structure of the world economy. Second, to the extent that individual countries, or regions, utilize policy space, we get more fragmentation in the global governance regime. The question then is how to institute 'traffic systems' between the more diversified sets of rules, so as to reduce transaction costs without everyone having to play by the same rules? Third, will China use its growing influence in global economic governance to press for more policy space in global and regional rules, in line with what it has actually done; or will it start to behave like a core country and support a Washington Consensus agenda by some other name? And fourth, how are we 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? Of course, the US, with its dollar conferring an 'exorbitant privilege', is a conspicuous exception to asymmetric adjustment pressure on deficit countries.

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