

States and Networks as Drivers of East Asian Development

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Abstract

As paragons of development East Asian economies have challenged international academia and policymaking. This paper aims at probing two theoretical strands applied to East Asian development, i.e. state-centric and network theories. Despite these theories' overt merits, their explanatory power can be improved by incorporating politics and culture in a novel framework.

Keywords: economic development, state-centric approach, network theories, East Asia

1. Introduction

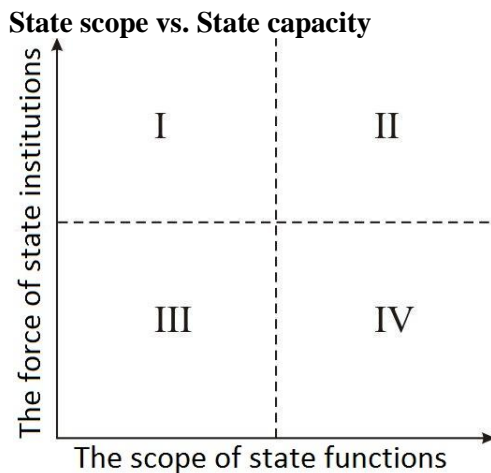
The relative power and prestige of nation-states have waxed and waned in the post-war era. State emasculation stems from various sources: the swift advance of globalisation and European Union (EU)-like regionalism, business cycles, changes in academic fashion, etc.

Major disruptions in the 1970s, namely the Vietnam War, the oil shocks and the ensuing economic ills, i.e. stagflation and rampant unemployment in OECD countries, catapulted these states into a position of crisis management orchestrators. The subsequent recovery of the world economy coincided with the advent of Reaganomics and the further expansion of transnational corporations (TNCs). By and large, the neoliberal philosophy instilled by Anglo-Saxon conservative régimes advocated a minimal state, and free markets. The Washington Consensus encapsulates this new drive by extending a supposedly felicitous Western approach to developing economies seeking to transcend their peripheral status in the world economy. Enforcing this corpus of liberalisation policies became a precondition for accessing World Bank and IMF support. As shown by the experience of Latin America, and Central and Eastern Europe respectively, this 'market fundamentalism' (Stiglitz, 2002) needed to be toned down to comply with both economic and social developments. The Post Washington Consensus addresses these shortcomings and posits a higher role for the state and its supporting institutions. The ongoing financial crisis has again turned nation states into steering commanders of their respective economies as fiscal stimulus packages were put forth, and subsequently restrained to avoid overheating (IMF 2011).

Scholarly treatments of nation-states have run parallel to geopolitical and economic developments. Thus, if academic circles envisioned the state as a powerful force during the late 1970s, a decade later it had turned into a ghost of its former glory (Weiss, 1998) only to resurface with a vengeance during the current global slowdown. The remainder of this section briefly presents two taxonomies of nation-states as envisioned by Fukuyama (2004) and Weiss (1998).

Fukuyama (2004) targets two dimensions of state action: the range of functions a state takes on (minimal, intermediate, activist), and the strength of its public institutions (i.e. its capacity to formulate and enforce laws and policies). Plotting these two dimensions yields a four-quadrant matrix¹.

Figure 1



Source: Fukuyama (2004), *State-Building: Governance and World Order in the 21st Century*

The first quadrant (minimal state endowed with strong institutions, illustrated by the United States) is deemed best from an economic perspective. East Asian first-generation developmental states (i.e. the Northern tier: Japan, South Korea and Taiwan, which have yielded a more mature type of capitalism) as well as some European states (France and Germany) belong to the second quadrant (extensive state, strong institutions). The first quadrant is positively correlated with efficiency, whilst the second is associated with social justice.

For Fukuyama state capacity prevails over state scope², and helps explain the development lag between East Asia and Latin America, for example.

Weiss (1998) addresses a nation-state's *transformative capacity*, namely its ability to initiate and enforce major long-term projects. A classification according to this criterion yields three state typologies. Firstly, *liberal states* (Great Britain and most of its ex-colonies, the US, Canada, Australia and New Zealand) that uphold market supremacy and individual freedom, and only occasionally resort to market intervention. Secondly, *interventionist* or *developmental states* acting via industrial policies and close government-business linkages (Japan, Germany). Thirdly, *corporatist states*, which can be placed between the two aforementioned extremes as they excel at redistributive interventions (typified by Scandinavian countries).

Irrespective of authority and conceptualisation shifts, referring to the Northeast Asian development models³ (i.e. Japan, South Korea and Taiwan⁴), the strong legacy of state involvement in industrialisation and institution building has not been significantly altered by globalisation as their peculiar capitalism has not converged with the

¹ This matrix lends itself to both static and dynamic interpretations. For example, starting from the 1980s Japan has taken a pernicious south-western trajectory because of external liberalisation pressures running parallel to the deterioration of its famous bureaucracy (Fukuyama, 2004; Pempel, 1998; Pekkanen and Kellee, 2005).

² A rich body of literature emphasises the centrality of institutions to economic development (s. North, 1990; Powell and DiMaggio, 1983; Rodrik, 2004; Stiglitz, 2002, 2006)

³ Analysts differ in their grouping of East Asian developmental states. Perkins (1994) breaks down the East Asian development model into three submodels: (i) the Northeast Asian tier, (ii) the entrepôt economies of Hong Kong and Singapore, (iii) ASEAN-4 and China. For Doner et al. (2005) Perkins' first two groups exhibit developmental state features, i.e. powerful institutions and industrial deepening, whilst the last two are simply 'intermediate states'. Other analysts work with a two-way division by generations: first-generation development models, meaning the Northeast tier, and second generation development models, i.e. Perkins' groups (ii) and (iii) (Low, 2006).

⁴ Alongside high institutional capacity, first-generation East Asian development models (i.e. Japan, South Korea and Taiwan) share a particular policy pattern (propensity for export-oriented industrialisation, high investment and saving rates, the centrality of industrial policies working in tandem with trade policies, etc.), relative national homogeneity, social cohesion, and a set of sociocultural traits subjacent to Neoconfucianism.

Anglo-Saxon model despite liberalisation pressures by the US, and the changes induced by the Asian financial crisis. That is why developmental states are hard to dismantle (Beeson, 2009), nonetheless adjustments are a must to avoid impeding growth.

The remainder of this paper is organised as follows: Section 2 examines the main tenets of the developmental state paradigm (DSP) as applied to East Asia. Section 3 reviews its limitations. Section 4 presents a set of network theories aimed at refining the explanatory power of DSP, and examines their drawbacks. The next section proposes to move beyond the scope of DSP and network theories by integrating political considerations. The last section concludes.

2. The developmental state: underlying hypotheses and implications for economic development

2.1. Introduction

Unlike neoclassical theory DSP posits that the East Asian miracle is due to an institutional échaffaudage rather than a pro-market corpus of policies. The developmental state⁵ is deemed the engine of the region's economic performance. This hypothesis does not rule out the role of the market, which is not altogether repressed but rather subsumed to state guidance⁶ or coordination (s. Wade's famous syntagm, "governing the market", 1990 or the label "coordinated market economies", Weiss, 1998).

Since East Asia has succeeded in reaping "rapid and shared growth" outstripping the rest of the developing world (Islam et al., 2000), its trajectory has far-reaching implications for development theory and policymaking.

2.2. Highlights of the hard core DSP

This section provides an overview of three major DSP representatives, i.e. S. Haggard, R. Wade and A. Amsden, who tackled the first-generation development models. Despite particular national differences, the developmental state concept is articulated around the following scenario: a meritocratic bureaucracy insulated from pressure groups wisely wields a policy toolkit in order to achieve long-term economic development.

According to Haggard (1990) two hallmarks of the East Asian state are macroeconomic stability, and the pursuit of export-oriented development strategies⁷.

Wade's approach (1990) resonates with Haggard's writings as the former explains the 'big push' by referring to authoritarian regimes, Weberian-like bureaucracy and its insulation from special interest groups. East Asian economic performance derives primarily from state capacity to wield economic policies to allocate resources to industries deemed strategic, a practice commonly referred to as *cherry picking*. The underlying hypothesis is that the private sector would not venture into this direction on the long term. That is the way governments can nurture national champions, and forge national competitive advantage (Porter, 1990).

⁵ The term 'developmental state' is not confined to the East Asian region although it has been applied to it quite frequently due to its felicitous 'big push' endeavours.

⁶ This sets developmental states apart from communist states: the former are 'plan-rational' (Woo Cumings, 1999), whereas the latter are 'plan-irrational' (Johnson, 1982).

⁷ This occurs for three main classes of reasons. Firstly, policy formulation was insulated from interest groups due to feeble parliamentary traditions, and to the practice of delegating state authority to competent bureaucrats. The Ministry of International Trade and Industry (MITI) is a classical example in this respect. The second reason is the low influence of anti-reform groups (farmers, trade unions, uncompetitive industries) either because of poor organisational capacities or because they were co-opted in the developmental state's démarche through side payments. Japan's Liberal Democratic Party (LDP)'s "embedded mercantilism" aptly illustrates this. In the 1960s (*annus mirabilis*, Pempel, 1998) the LDP managed to forge an unprecedented social consensus by supporting these vulnerable categories alongside competitive export-oriented industries and companies. Thirdly, post-war geopolitical games turned the US into a strategic ally of East Asia, which stood to be engulfed by the Soviet Union. The Americans extended economic and military assistance to the Northeast tier economies. Further, the US's liberal philosophy played a major part in the region's export-oriented industrialisation. This is understandable given America's hegemonic stance after World War 2 (s. also Gilpin, 2000; Weiss, 1998)

Amsden (1990) emphasises the East Asian state's capacity to induce beneficial long-term orientations by resorting to the same line of arguments as the two prior scholars: authoritarian régimes, competent experts, and isolation from pressure groups. Intervention is legitimated by the necessity to bridge the gap vis à vis advanced economies. States can use multiple levers, for instance price manipulation, financial repression (s. President Park's approach in South Korea, Park, 2000; Park, 2001), encouraging consumer saving for cherry picking purposes, etc. (s. the Japanese postal savings system, Pempel, 1998; Park, 2000).

2.3. DSP Extensions

Interesting DSP extensions include Olson's 'encompassing organisations' and Rodrik's multiple-equilibria model for countries with intermediate factor endowment. Olson (1982) compares the East Asian state with high-scale 'encompassing organisations' that do not fall an easy prey to "myopic" interest groups pursuing narrow objectives as they engage in zero-sum games. Quite the reverse, the East Asian state is conceptualised as a "quasi-internal organisation" à la Williamson (s. also Lee, 2002), which engages in positive-sum games, and is endowed with a high potential to promote economic growth. According to Rodrik (1996), deliberate state action can shift East Asian economies⁸ from a low-tech equilibrium to a high-tech equilibrium. Interdependent decision-making by states and businesses in upstream and downstream industries will prevent market failure and catapult medium countries to the higher end of the value chain (Rodrik, 2004).

3. Limitations of the developmental state paradigm (DSP)

3.1. Simplistic conceptualisation of the nation-state

According to the DSP, a nation-state is akin to a monolithic block acting in a consistent and unitary fashion. It heavily relies on experts that are insulated from sociopolitical pressure in ways reminiscent of a Weberian bureaucracy. Actually Mann (1993) contends that any state is a complex heterogeneous organisation incorporating various classes of protagonists (the three powers and the technocrats) whose professions, interests, and ideologies differ. Consequently, nation-states are fraught with systemic inconsistencies that become transparent through various crystallisations that do not necessarily resonate and can come to prevail under certain geopolitical and economic contexts.

3.2. Inadequate conceptualisation of state-society linkages

The state-centric paradigm posits a beneficial rift between the two entities, actually East Asian bureaucrats have hardly resided in an ivory tower: there are simply national differences regarding on the one hand the ways connections (formal, informal, both) are forged with civil society or social groups targeted by specific policies, and, on the other hand, regarding the strength of these connections. Table 1 captures remarkable differences between the interaction models between bureaucrats and private businesses: thus, Japan and South Korea exhibit nearly antithetical models, whilst Taiwan is an intermediate case. These differences have also left their imprint on the industrial organisation in the Northeast tier economies.

Table 1: Bureaucrats-business linkages and implications on industrial organization

Country	Type of linkages between bureaucrats-business milieu	Industrial organisation
Japan	Horizontal, consultative and organic	<i>Keiretsus</i> surrounded by small subcontracting firms
Taiwan	Far more diffuse	Symbiosis between downstream small and medium enterprises (SME) and upstream big state-owned enterprises (SOE)
South Korea	Vertical, selective and exclusive	<i>Chaebols</i>

Source: Author's systematisation after Okimoto (1989) and Weiss (1998)

⁸ The underlying assumption is that countries fall into three big classes depending on their initial factor endowment. The first class includes rich countries whose strong endowment in both physical and human capital enables them to specialise in the production of sophisticated, technology-intensive goods. The second type is made up of poor countries whose capital shortage pushes them to manufacture standardised labour-intensive goods. The third class is placed in-between: high-quality human capital coexists with scarce physical capital. East Asian economies illustrate this last type as they vacillate between two types of equilibria, a low-tech equilibrium, and a high-tech equilibrium. Ultimately state involvement will tip the balance toward the latter, which is why Rodrik claims this intermediate situation illustrates a possible market failure that the state is called upon to fix (Rodrik, 1996; Rodrik, 2004).

3.3. The incontrovertible positive correlation between economic performance and the state's steering role

Two tenets of the DSP paradigm have been critiqued. Firstly, the outgrowth of state involvement is the formulation and enforcement of efficient policies. Counterexamples are easy to find. For instance, Japan has applied irrational policies in order to support vulnerable social groups (farmers, traditional industries, and small retailers), and prevent conflicts (Pempel, 1998; Pekkanen and Kellee, 2005). That was the way to safeguard social harmony in the golden 1960s. Although statist blame underdevelopment on market failures, instances of government failure are not infrequent. Despite its reliance on a meritocratic bureaucracy, the famous MITI was not error-proof in its cherry picking endeavours (Gilpin, 2000). In a similar vein Taiwan failed lamentably in its attempt to formulate an adequate industrial policy.

Secondly, economic development is the corollary of these policies⁹. This assertion typifies the *post hoc ergo propter hoc* fallacy because it is difficult to ascertain if specific industries or businesses developed due to state support, selection of the fittest in the marketplace or a combination thereof (Johnson, 1982).

4. Attempts at rescuing DSP via network theories

4.1. Embedded autonomy

Evans (1995) puts forth this concept to discriminate between East Asian régimes and neopatrimonial ones peculiar to Sub-Saharan Africa (s. Fukuyama, 2004). He explains why the former do not wield their authority to spoliolate their respective societies but act instead as benefactors engaging in developmental pursuits. That is because the East Asian state is embedded in society without being captured by narrow interest groups (s. also Haggard, 1990; Wade, 1990; Weiss, 1998; Olson, 1982). Its functional links occur on the one hand vertically, with the state posing in absolute commander vis à vis civil society, and on the other hand horizontally, actualised via organic networks that are both formal and informal in nature. Vertical connections yield discipline and obedience whilst horizontal links breed consultation and consensus. Evans concludes that the interaction between these two connection types is beneficial as it is conducive to harmony and information exchange, and eventually leads up to economic performance.

The 'embedded autonomy' concept is valuable as it transcends the artificial dichotomy between state and society posited by DSP to reveal the complex interplay between these two entities.

However Evans's approach is rather idealistic as it brings to the fore the bright side of state-society interactions, and the respective implications in the economic realm. The trends of the 1990s in Japan (s. Pempel, 1998; Pekkanen and Kellee, 2005) and in Korea in the mid-1980s through the 1990s (Park, 2000; Shin, 2000; Lee, 2002) debunk the myth of ivory tower bureaucracy, competence and insulation from civil society in general, and the business milieu in particular.

4.2. Networks for negotiating public policies

Okimoto (1989) proposes a diverging hypothesis revolving around the concept of network-state, where all major protagonists connect via informal links consolidated through formal ones¹⁰ (under the guise of councils, fora, etc. debating on topical issues of Japanese or South Korean societies). Consequently, transaction costs that would normally occur during such debates are bound to decrease. Thus East Asia's economic performance (especially for the Northeast tier) does not stem from the supremacy of a competent authoritarian state formulating efficient economic policies from centre stage but rather from the ongoing interaction between the state and the private sector, which "negotiate" industrial policy. This government-business relationship is not one of dependency but rather one of interdependency or synergy, symbiosis even.

⁹ S. here Porter's theory of the competitive advantage of nations (1990): the national diamond (a metaphor for national competitiveness) is fashioned out where four broad classes of factors attain a climax. Both chance and government intervention can impact upon them, yet certain socioeconomic factors escape state influence (for example, sociocultural factors).

¹⁰ S. also the role of *amakudari*, a current practice cementing such links, but which could ultimately degenerate into interest clashes, and corruption (Pempel, 1998).

4.3. The theory of coordinated interdependencies

Weiss (1998) extends Evans' concept of "embedded autonomy" by highlighting government-business linkages. Her theory breaks away from Wade's theory of the governed market from two angles: firstly, by assuming that East Asian companies can easily adjust to economic change because they rely on a system that socialises risks¹¹; second of all, in line with Okimoto (1989), she claims that the government-business nexus is efficient precisely because industrial policies are an outgrowth of negotiation and consultation with the private sector, not the outcome of a top-bottom approach.

4.4. The East Asian state as a quasi-internal organisation

Lee (2002) applies Williamson's theory on corporate governance optimisation to the East Asian state comparing it to a "quasi-internal efficient organisation". According to this theory, the East Asian state prevails over the private sector (unequal partnership).

For Williamson the M-form firm represents the best possible organisation because it minimises transaction costs originating in information asymmetry and the participants' opportunistic behaviour. This firm is divided into two parts playing different roles: the headquarters, and a string of operating divisions. The headquarters formulates corporate strategy, whilst the divisions apply it. The headquarters is also monitoring strategy implementation, and is taking a 'sticks and carrots' approach by rewarding high-performing divisions in its portfolio (via resource allocation, wage raises, bonuses, etc.), and penalising the loss makers.

Mutatis mutandis, the East Asian state (alias the headquarters), and the private sector (i.e. the divisions it is supervising) make up a quasi-internal organisation. In fact, this last theory goes further than the two prior one, which envisaged linkages between the two entities in terms of interconnectedness conducive to economic performance. In this case the two protagonists have fused, hence the "state-network" concept. The state acts as if it were managing a huge capital market, and investing in 'attractive' portfolios, whilst discarding or penalising the poor ones. This theory captures the East Asian state's propensity to select a group of top priority industries, which will spearhead its economic development (*cherry picking*) on the long term. This option is legitimated by the fact that the private sector would tend to invest in industries yielding profits on the short term (s. Wade, 1990). Further, these states choose export-oriented industrialisation, and assiduously protect their home markets from foreign competition to allow their infant industries to grow.

To sum up, the first and the last theories consolidate DSP as they retain the state domination hypothesis, whereas the second and the third undermine it because they foreground partnership.

5. Limitations of network-based theories

By and large all these approaches suggest that East Asian political reality is permeated with 'harmony and stability' (Chan et al., 1998), which prompts two major critiques.

Firstly, networks are unstable entities as the interests of both political régimes, and the business milieu evolve, and can clash violently at times. For example, in the mid-1990s the *chaebols* lobbied for financial liberalisation in order to raise foreign funds for their unrelated diversification frenzy, and accumulated huge short-term debt, which rebounded on South Korea during the Asian financial crisis (Park, 2000; Shin, 2000; Park, 2001; Lee et al., 2002; Kim et al., 2005). In the meantime Korea had turned from a 'developmental state' into a 'racketeering state' (Park, 2001)

Secondly, as networks mature, they decay because participants tend to engage in corrupt practices. Pempel (1998) aptly illustrates this point: for Japan the 1990s are a hard cry from the harmony of the 1960s, when the Liberal Democratic Party had secured control over the political stage, and had instated 'embedded mercantilism'. Instead, the 1990s, the *anni horribili*, revealed a string of corruption scandals involving top level politicians that outraged not just ordinary citizens but also the private sector. Thus businessmen began to lobby for a change in a *statu quo* they deemed pernicious.

¹¹ These risks include but are not limited to raising capital, developing new products and technologies, finding new markets and training human resources (Weiss, 1998).

6. Interpreting DSP and network theories failure

Firstly, the state-centric approach and the four network theories abstract away from the dynamics of the East Asian landscape. This occurs for a variety of reasons: state heterogeneity (Mann, 1993); antagonism is likely to prevail over harmony in interactions between nation-states and local networks (unlike in Okimoto (1989)), therefore policy options may be determined by rivalry rather than co-operation; non-altruistic objectives are likely to prevail over developmental pursuits. The actors in charge with formulating and enforcing economic policies may pursue self-serving objectives (s. public choice theory, Buchanan and Tullock, 1962). Thus, *the polity* chooses policies ensuring and legitimising its political survival. *Bureaucrats* are biased in policy drafting and implementation given the vertical linkages with political leaders (subordination), and horizontal linkages with political institutions, whether ministries or state agencies (rivalry). *Social groups*, such as employers and trade unions, can resort to various strategies to influence economic policies. Further, cooperation or non-cooperation with the government can influence economic performance. For example, the Asian financial crisis plunged some economies into recession, moreover the social riots that ensued, especially in multiethnic areas (Indonesia and Malaysia) aggravated the ratings of crisis-stricken economies (Stiglitz, 2002; Beeson, 2002).

Secondly, these two types of theories err in positing an unfailing positive correlation between institutions (the benign authoritarian state in the former case, the more or less politicised networks in the latter), and economic performance. These are second-best theories because they remove politics from the equation (Doner et al., 2005). A relevant approach should integrate politics and economics as international political economy advocates claim (Gilpin, 2000).

A vivid illustration on how politics impacts upon economic institutions is the relative power balance between the executive and the legislative (presidential, parliamentary or mixed régime), which can yield different options in terms of economic policies.

Table 2 Economic implications of the executive/legislative power relationship

	Japan	South Korea
Régime type	The legislative prevails over the executive	The executive prevails over the legislative
Economic implications	Weakening of the executive's power	Domination of the executive
	Horizontal relations between the prime minister and ministries/ governmental agencies	Vertical relations between the executive and bureaucracy
	Tighter compartmentation of bureaucratic agencies (with overlapping competencies even) and increased inter-ministry rivalry	Negligible intra-bureaucratic disputes

Source: Author's systematisation after Woo-Cumings (1999) and Weiss (1998)

Further, institutions are shaped by cultural legacy. East Asia is dominated by Neoconfucianism, which can be further broken down into several regional variants (Pye, 1981): Feudal Confucianism (Japan and Korea), Paternalist Confucianism (Greater China economies), Client Paternalistic (Thailand, Malaysia), Client Pathological (Indonesia, Philippines).

A new theoretical framework on East Asian institutions needs to integrate both politics and culture.

Conclusions

The two sets of theories predicated upon institutional arrangements (developmental states and/or the policy networks surrounding them) fall short of the complexities of East Asian development. Neoliberal and cultural accounts of the area's rise and apparent downfall during the Asian financial crisis are fraught with controversies, too.

Nevertheless a novel approach integrating political and cultural inputs could help overcome the deficiencies of the abovementioned theories.

Even if the authoritarian political régimes in East Asia have been highly successful up to a point through their neomercantilist policies, and business-government nexus respectively, globalisation, especially on the financial front, seemed to indicate in the late 1990s on the one hand, that their approach is unsustainable, and needs to be refined, and on the other hand that EU-like regional integration can be an alternative for alleviating external pressure. Ironically enough, with the recovery of East Asian states from the global slowdown, and the negative developments in the Eurozone, the reverse seems to be true.

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