



INTERNATIONAL
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IFPRI Discussion Paper 01597

January 2017

**Perspectives on the Role of the State in
Economic Development**

Taking Stock of the “Developmental State” After 35 Years

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ABSTRACT

Over the past 50 years, the economies of 10 East Asian countries—Taiwan, South Korea, Singapore, China, Thailand, Hong Kong, Indonesia, Vietnam, Malaysia, and Japan—grew faster than those of nearly any other country in the world. For almost as long, scholars and policy makers have examined why these countries experienced not only remarkable levels of growth but also structural change, which has been driven by rising productivity, declining levels of inequality, and real increases in the standard of living. The goal of researchers and policy makers alike has been to uncover lessons that can be applied to developing countries today. Out of these efforts emerged the idea of the “developmental state,” which is based on the recognition that the state actively intervened in markets to facilitate and accelerate structural transformation. This review evaluates the role of the state in development, offering a new framework for understanding what capabilities states need to overcome different types of market failures. This framework is employed to understand the successes and failures of state-led development in Malaysia.

The review addresses three key questions. First, what do we know about developmental states and why they emerged? Second, what have developmental states achieved? In answering this question, I look not only at growth but also at structural transformation, economic “upgrading,” equity, and human capability enhancement. In contrast to the idea of a single “East Asian model” of development, I find five distinct development trajectories. Third, how did developmental states utilize state structures to pursue development? To answer this final question, I examine in depth the history of state-led development in Malaysia—including agricultural, industrial, and social policies. This case study sheds light on what specific institutional and political capacities helped Malaysia to improve productivity in agriculture, expand the manufacturing sector, and reduce inequality. It also explores why Malaysia has been less successful in developing linkages with the export-based manufacturing sector.

The case study clarifies future research questions concerning the role of the state in development, including: How does the consensus develop among ruling elite to pursue state-led development? In particular, why did Malaysia and other states in Southeast Asia decide to emphasize rural development before industrialization? Why was Malaysia more successful in state-led agricultural development compared to industrial development, and can lessons from Malaysia’s success in promoting rural development be applied to developing countries today? How has Malaysia developed its strong ability to monitor policy implementation and to ensure service delivery? Revisiting these questions is particularly important today, as meeting the complex and multidimensional goals outlined in the Sustainable Development Goals will require an expanded vision for state involvement.

Keywords: governance, Asia, developmental state, state capacity, agricultural policy, industrial policy, Malaysia

ACKNOWLEDGMENTS

This work was undertaken as part of the CGIAR Research Program on Policies, Institutions, and Markets (PIM), which is led by the International Food Policy Research Institute (IFPRI) and funded by CGIAR Fund Donors. I am grateful to the U.S. Agency for International Development (USAID) for extending support to conduct this study through ReSAKKS-Asia. A special thanks to Danielle Resnick for comments and to Jane Lole for research assistance on development outcomes across the region. This paper has not gone through IFPRI's standard peer-review process. The opinions expressed here belong to the authors, and do not necessarily reflect those of PIM, IFPRI, CGIAR, or USAID.

ACRONYMS

AFC	Asian Financial Crisis
ASEAN	Association of Southeast Asian Nations (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam)
ASEAN-4	Four countries with largest economies among ASEAN (Indonesia, Thailand, the Philippines, and Malaysia)
BN	Barisan National
DAP	Democratic Action Party
DRA	Development Regimes in Africa project
EPB	Economic Planning Board (South Korea)
EPU	Economic Planning Unit (Malaysia)
ETP	Economic Transformation Programme
FELDA	Federal Land Development Authority (Malaysia)
FDI	foreign direct investment
GATT	general agreement of trade and tariffs
GDP	gross domestic product
HICOM	Heavy Industries Corporation of Malaysia
IMF	International Monetary Fund
KPI	Key Performance Index
MCA	Malaysian Chinese Association
MITI	Ministry of International Trade and Industry (Japan)
MP	Member of Parliament
NDP	National Development Policy
NECC	National Economic Consultative Council (Malaysia)
NEP	New Economic Policy
NIC	new industrializing countries (East Asian NICs are primarily South Korea and Taiwan, though Hong Kong and Singapore are sometimes included)
Pemandu	Performance Management and Delivery Unit (Malaysia)
PPP	purchasing power parity
UMNO	United Malays National Organization
WDI	World Development Indicators

1. INTRODUCTION

Between 1960 and 1995, the economies of 10 East Asian countries—Taiwan, South Korea, Singapore, China, Thailand, Hong Kong, Indonesia, Vietnam, Malaysia, and Japan—grew faster than those of nearly any other country in the world. This remarkable growth—known as the “Asian miracle”—has attracted widespread attention from scholars and policy makers alike. Aside from their geographical concentration, these countries have little in common. They include those with large populations (China, Indonesia), those that have valuable natural resources (Indonesia, Malaysia), those with scant natural resources (South Korea, Singapore), those that are relatively culturally homogeneous (Taiwan, Thailand, Japan, Vietnam), and those ranking among the most diverse in the world (Indonesia). What sets these economies apart and has made them the subjects of countless studies and reports was not just their spectacular growth but the way in which it was achieved. In each of these economies, the government played a significant role in the development process: planning and implementing development strategies, providing subsidies and incentives to private actors to invest in targeted industries and sectors, and making strategic public investments to complement private investment. Rather than relying on market forces to determine the optimal allocation of capital and resources within the economy, governments did so.

This “developmental state” model was pioneered by Japan and emulated across the region—first by South Korea, Taiwan, Singapore, and Hong Kong and later by China, Vietnam, Malaysia, and Indonesia—in varying forms and with varying degrees of success. That these countries could exit the “periphery” of the global economy and do so while providing state subsidies and industry protections defied prevailing schools of thought. Dependency theory emphasized that developing countries were stuck at the bottom of a global economic hierarchy. Alternatively, neoliberal economic theory posited that state intervention in markets, coupled with protectionism, would preclude the development of globally competitive industries.

This paper reviews the literature on developmental states in Asia, nearly 35 years after the concept was first introduced by Chalmers Johnson in *MITI and the Japanese Miracle* (1982). One of Johnson’s central claims was that the astounding structural transformation of the Japanese economy was neither accidental nor an inevitable product of its geography, factor endowments, and uncoordinated market forces; instead, its success was the result of a deliberate, planned effort by the Japanese state to intervene in markets in order to guide economic development.

The idea that state intervention could be a source of economic development rather than a hindrance to it was revolutionary to academic audiences. Yet, other states in East Asia—the “new industrializing countries” (NICs) of South Korea, Taiwan, Singapore, and Hong Kong—had already drawn lessons from the role of the state in Japanese industrialization. They had begun to implement their own versions of the “developmental state” pathway to growth. Inspired by the NICs, Malaysia, Thailand, and Indonesia later followed this pathway. The accumulation of successful cases of state-led development across East Asia garnered significant attention in academic and policy circles, inspiring a vast literature on developmental states.

In recent years, however, many have begun to question whether this literature holds any relevance for developing countries today. The Asian Financial Crisis (AFC) brought about a collapse in confidence in governance that caused many to question whether the developmental state could be a replicable model for long-term growth. As Wade (2000) put it, the consensus became that “the Asian model ... worked for a time but then stopped working; hence the crisis” (87).¹ The literature on developmental states has been undermined by its relative inattention to the troubling human rights records of many developmental states—in particular, repression of labor—and its seeming acceptance of the authoritarian character of the states it reviewed “as simply one aspect of ‘the autonomy of the state,’ which was somehow made bearable by ... [their] spectacular success in development” (Mkandawire 2010, 70). In light of this, the Developmental Regimes in Africa (DRA) project declared that “there is no longer a need to rely on

¹ However, Wade (2000) himself contends that the AFC was caused not by failures of governance but rather failures of international financial markets.

‘developmental state’ concepts that draw narrowly on lessons from East Asia” (Booth et al. 2015, v). Others contend that the unique historical context of Northeast Asia in particular—the Cold War environment, the more forgiving international environment for protectionist trade policies, and exceptionally high state capacity—render its experiences irrelevant to those of developing countries today (for example, World Bank 1993). Although less frequently discussed, one might also question the desirability of development pathways based heavily on environmental exploitation and damage, particularly in Southeast Asia. Finally, it is worth noting that some were never convinced of a distinctive model of Asian growth at all. The “Krugman thesis” posits that East Asia’s growth was the product of extraordinary deployment of inputs—high savings rates, high education levels, and vast increases in labor force participation brought about by the mass movement of peasants into modern sectors—and not by any particularly Asian model of development (Krugman 1994).²

Despite growing reluctance among scholars to praise the developmental state as a pathway to long-term growth, its influence among policy makers in developing countries persists. Most prominently, China has adapted lessons from Japanese development to its own social and institutional context, pointing to the lasting legacy of the developmental state as well as its ability to adapt to the modern global economy (Beeson 2009). Indeed, when China released its new industrial policy in 1994, officials reported having done extensive research on the industrial policies of the Ministry of International Trade and Industry (MITI) in Japan (Noble 1998). The Chinese adaptation of state-led development has resulted in its own “model” of development, the so-called “Beijing Consensus.” In Ethiopia, there was a strong desire to emulate the Japanese industrialization experience. In fact, the Ethiopian Constitution borrows heavily from its Japanese counterpart, and the ruling elite today look consistently to South Korea and China for lessons (Fourie 2012). Kenya’s *Vision 2030* modernization plan, meanwhile, is based heavily on the experiences of Singapore and Malaysia (Fourie 2014).

Among donors and international financial institutions, the idea that the state plays a prominent role in development has also seeped into development orthodoxy through its focus on “good governance,” and an increasing recognition that state failures can be more detrimental to long-term growth than market failures. However, the good-governance agenda has focused far more on curbing and restraining rent-seeking than on the positive and transformative roles the state can play in development. In other words, good governance has focused far more on what states shouldn’t do—enable rent-seeking, violate private and intellectual property, overregulate the private sector, mismanage public funds—than on what they should do and how they should do it. Empirically, the focus on security of property rights and restraining the state draws primarily from the premodern European development experience, largely overlooking opportunities to draw lessons from the substantially different, and more contemporary, role of the state in East Asian development.³

Re-examining the East Asian growth experience and the role of the state in development is particularly important today, as policy makers increasingly set a broader range of development goals than economic growth alone. The Sustainable Development Goals, for example, emphasize reducing poverty, ending hunger, improving health and the quality of education, establishing gender equality, protecting the environment, and reducing inequality. With these more multidimensional goals, we are in need of an expanded vision for the potential role of the state in development. Beyond the narrow focus on its role in protecting private property rights, state capacity could be harnessed to resolve coordination failures, overcome collective action problems, make public investments, and absorb risk.⁴

² Yet, one might ask what role the government played in increasing savings and education levels and in improving agricultural productivity that enabled the mass deployment of labor.

³ However, the role of state intervention in the economy, including the use of industrial policy and export subsidies to promote early industrialization, may be underplayed in historical accounts of the United States and of Western Europe (Chang 2002).

⁴ In a similar vein, a recent review on the role of the state in development (Bardhan 2016) advocates revisiting the developmental state literature and the East Asian growth experience more generally to examine the state’s role in resolving coordination failures and promoting structural transformation of the economy.

The development experiences of East Asia are also becoming salient today due to the increased focus on structural transformation as key to long-run growth. Given the large number of transactions that must take place between unrelated parties when expanding the manufacturing sector, the specific institutional configurations that enabled and facilitated these transactions are of particular interest. The shift in employment out of agricultural and into manufacturing—often seen across East Asia—strongly enhanced growth. Yet many African economies face a significant deficit in the size of their manufacturing sector, even accounting for low income levels (Newman et al. 2016). This “industry gap” has led to calls for increasing emphasis on industrial policy—a key component of Asian developmental states—in Africa to promote the growth of industry (for example, Whitfield et al. 2015).

With this in mind, this review re-examines the literature on the developmental state in both Northeast and Southeast Asia. It begins by addressing what counts as development when discussing developmental states, noting that the literature is surprisingly divided on this question. The classic literature on the East Asian miracle focuses primarily on economic growth. More recent accounts have emphasized (1) structural transformation; (2) economic upgrading, or the extent to which sectoral diversification is based on foreign direct investment in labor-intensive manufacturing vs. local innovations and productivity enhancements; and (3) human capability enhancement, or improvements in human cognition, life expectancy, and political and civil rights. I take stock of the within-region variation in development achievements along each of these dimensions, as well as how East Asia as a whole compares to Latin America, Sub-Saharan Africa, and the Middle East and North Africa. I argue that rather than a single model of East Asian development, at least five distinct development trajectories can be identified within the region:

- *Inclusive transformation*: Characterized by high economic growth, structural transformation, economic “upgrading” (that is, moving into high-value-added, high-efficiency products, using local inputs) and low or decreasing levels of inequality. Although this growth pathway is inclusive in the sense of being accompanied by low levels of inequality, it is frequently associated with authoritarianism and repressive policies in East Asia.
 - Japan, South Korea (1960s–1990s), and Taiwan most closely fit this development trajectory. Malaysia also fits, though to a lesser extent, having achieved reductions in inequality and significant structural transformation but less upgrading.
- *Unequal upgrading*: Characterized by high economic growth and upgrading, but high and/or increasing levels of inequality.
 - China (1980s to the present), Hong Kong, and Singapore most closely fit this trajectory.
 - Vietnam (1990s to the present) may also fit this pathway, though it is more difficult to assess inequality trends and upgrading.
- *Incomplete transformation*: Characterized by high economic growth and sectoral diversification, but limited productivity improvements. Often accompanied by high and/or increasing levels of inequality.
 - Indonesia, Thailand, Cambodia (1990s to the present), and Laos (1990s to the present) most closely fit this trajectory.
- *Low growth capability enhancement*: Characterized by low economic growth, but unexpectedly high levels of human capability enhancement—for instance, educational attainment and life expectancy—given relatively poor economic performance. This growth pathway tends to be associated with more democratic institutions and political freedoms within East Asia.
 - The Philippines and Mongolia most closely fit this development trajectory.

- *Poor performers*: Characterized by low economic growth, limited sectoral diversification, and limited expansions in capabilities.
 - Although there is significant variation within this pathway (for example, conflict-poverty traps, natural resource dependence, autarky, and repression), the countries are similar in having experienced generally low growth compared to others in the region.
 - This could describe Myanmar, Cambodia (pre-1990s); Laos (pre-1990s); and North Korea, Brunei, and Vietnam (pre-1990s).

An explanation for development in the region should be able to account for differences in these trajectories. To do so, the paper builds on two key concepts—developmental roles and developmental structures—to explain economic growth in the region.⁵

Developmental roles are defined by the specific sets of policies and actions that the state undertakes in pursuit of development. I cover three broad types of developmental roles: industrial policy, agricultural policy, and social policy. In focusing broadly across these policy areas, this review departs significantly from the developmental state literature, which focuses primarily on industrial policy. Agricultural and social policy—and the relative equality and high human capital that the policies produced—are typically treated as “initial conditions” necessary for state-led development, rather than as a deliberate part of the development strategy. For example, the significant land reforms implemented in South Korea and Taiwan in the aftermath of the Second World War, and the considerable reductions in inequality that they brought about, are often cited as a cause of their ability to industrialize as opposed to the overall role the state played in development. This tendency to treat agricultural and social policy as underlying structural conditions can also be seen in the “Krugman thesis” on Asian development. This thesis postulates that Asian growth can be explained primarily by high savings rates, high education levels, and the mass deployment of labor enabled by increases in agricultural productivity. If this is true, perhaps the “miracle” of Asian development lies in how the region was able to create these conditions when so many other developing countries could not.⁶ Examining agricultural and social policy as crucial parts of the overall strategy of state-led industrialization is one key contribution of the paper.

The paper argues that different development trajectories involve implementing development policies with varying levels of difficulty. For example, the policy challenges involved in bringing about “inclusive transformation” are more daunting than those involved in the “incomplete transformation” pathway. I identify a range of policy areas the state engages in along the inclusive transformation pathway. These include: (1) land reform; (2) agricultural productivity enhancements (for example, extension services, high-yield varieties); (3) agricultural input subsidies; (4) rural infrastructure; (5) macroeconomic stability; (6) trade liberalization; (7) the promotion of risky investment in new sectors; (8) supplier development; and (9) education and training. Successfully implementing a policy in any of these areas requires different types of institutional capacities, based on the difficulty the policy poses. Doner (2009) argues that development policies can be differentiated by three factors, each requiring different institutional strengths and designs. Specifically, the difficulty of development policies will depend on the following characteristics:

- The number of actors involved in policy implementation
 - How many actors must be involved to formulate and implement a policy successfully?
 - Are a large number of transactions required to implement a policy or deliver a service?

⁵ I adopt the “developmental roles” vs. “developmental structures” framework from Vu (2007), though I define and employ the concepts differently.

⁶ This expanded focus is consistent with the conclusions drawn by Routley (2012) that questions about the roles of agricultural and social policy merit further attention in the context of the developmental state.

- The complexity of the information required to formulate and implement the policy
 - How much technical knowledge is required to formulate and implement a policy?
 - Is there a clear solution, or do policy makers need to analyze and synthesize large amounts of information to develop one?
- The severity of the distributional consequences
 - Who stands to gain and who stands to lose from a given policy? How politically powerful are the potential losers?
 - How quickly are losses vs. gains experienced?

Therefore, for example, encouraging private investments in new sectors—a risky endeavor necessary in early industrialization—could be managed by a single agency working with a small number of firms, and involves little redistribution of wealth within society. However, the informational barriers may be quite high. By contrast, successfully promoting education and training the workforce requires the state to mobilize a large number of actors, though the informational barriers may be lower. Depending on the particular challenges posed by each policy area, different types of institutional capacities are required.

Developmental structures are the institutions through which governments pursue developmental roles. I emphasize two underlying dimensions of developmental structures that enable states to take on developmental roles and solve development challenges. The first is institutional capability, including the ability to consult, implement, monitor, and problem solve. Institutional capabilities are key to overcoming policy problems driven by the number of actors and the complexity of information involved. The second is political capability (that is, the ability to compel social actors to comply with a policy). Political capabilities are key to overcoming policy problems driven by the distributional consequences of development policies. Neither dimension is sufficient by itself to fully overcome developmental challenges. Autonomy from social forces enables states to select developmental goals based on their merit (rather than their benefit for a specific social group), but states still need organizational capacity to pursue their goals successfully. Similarly, states could possess a capable bureaucracy but use it in service of rent-seeking rather than development.

Together, the combination of developmental roles and developmental structures constitute developmental states. By focusing on the “fit” between policy challenges and institutional designs, this paper goes beyond the now-ubiquitous observation that good governance and strong institutions matter for development. Instead, it offers insights into what types of strong institutions, with which designs, and with what kinds of links to society are needed to implement which types of policies. Table 1.1 provides a summary of the main concepts and issues covered in this paper.

Table 1.1 Overview of key concepts

Concepts	Definition	Primary components
Developmental roles	Sets of policies and actions undertaken by the state in pursuit of state-led development. Each policy area is characterized by different types of policy challenges	<ul style="list-style-type: none"> • Agricultural policy • Industrial policy • Social policy
Developmental structures	Institutions through which the state pursues developmental policies and actions	<ul style="list-style-type: none"> • Institutional capabilities, including capacity for consultation with other agencies, implementing policies, monitoring implementation, and problem-solving • Political capabilities, determined by the state’s relationships with the elite and the masses, and the control of the central government over local governments

Source: Compiled by author.

Overall, the review aims to answer three key questions. First, what do we know about where and why developmental states emerged? This information is essential for understanding whether their developmental pathways can be replicated elsewhere, in countries with different historical legacies, institutions, and social structures. Second, what have developmental states achieved? In particular, how have developmental outcomes—growth, equity, structural transformation, economic upgrading, and capability enhancement—varied across East Asia? And third, how exactly did developmental states employ developmental structures to pursue developmental roles?

In answering this final question, I provide an in-depth examination of the history of development policies—including agricultural, industrial, and social policies—in Malaysia, one of the most successful cases of inclusive growth in the world. I focus on Malaysia rather than adopting the more typical focus on Japan, South Korea, and Taiwan for several reasons. The East Asian NICs have inspired a vast body of research and represent the most successful development trajectories in the world. However, many question whether their historical and social conditions make them comparable to developing countries today. Among these conditions are relative ethnic homogeneity, resource scarcity, bureaucratic capacity, distinct colonial experiences, and positions as U.S. allies during the Cold War. By contrast, Malaysia, with its history of European colonialism, ethnic diversity, and uneven bureaucratic capacity, may offer more fertile comparisons for developing countries today.

The remainder of the paper is as follows. Section 2 reviews the literature on the developmental state and its key characteristics, and Section 3 reviews the primary explanations for their emergence in East Asia. Section 4 re-evaluates the East Asian growth experience and revisits debates about what constitutes “development.” I find that, rather than a single model of development, there are several different development trajectories within the region. Each of these entails different capacities and roles of the state in development. Section 5 presents the theoretical framework structured related to developmental roles and developmental structures, providing an overview of the different policy challenges encountered in each of the development pathways and the institutional fit needed to overcome these challenges. Section 6 provides an in-depth examination of Malaysia’s development trajectory. It examines what mixes of agricultural, industrial, and social policies were implemented and the institutional structures through which they were implemented. Section 7 offers conclusions.

2. WHAT ARE DEVELOPMENTAL STATES? AN OVERVIEW OF THE LITERATURE

Chalmers Johnson described Japanese political economy as a plan-rational state, in which the state has “a strategic, or goal-oriented approach to the economy” (1982, 19). In a plan-rational state, he argues, industrial policy is seen as a means for achieving late industrialization. Although the state intervenes in the economy, in a plan-rational state the bureaucracy adheres to market-conforming means of state intervention. Johnson formulated the idea of the plan-rational state as a middle course between the “plan-ideological,” Soviet-style state in which state ownership of the means of production and state planning are not means to development goals but ends in themselves, and “market-rational,” in which the state concerns itself with the rules of economic competition but not with setting or pursuing specific goals.

Although Johnson’s book describes the Japanese political economy during a specific historical juncture (1925–1975),⁷ later scholars noted that NICs across East Asia adapted and applied the Japanese model to achieve their own development miracles. Prominent works by Amsden (1989) and Wade (1990), for example, made the case that South Korea and Taiwan, respectively, shared many features with the Japanese model and successfully utilized industrial policy to jump-start industrialization.

Thus, the “developmental state” became both a description of the political economy of particular countries in East Asia during a specific period, and a more general theoretical construct.⁸ As a construct, the core idea of the developmental state is that state intervention in the economy can initiate industrialization and economic growth.⁹ Johnson notes that the concept was “an ideological red flag,” (1999, 34) bucking up against neoliberal economic explanations for economic development that emphasized stable macroeconomic policies, market-oriented reforms, and trade and exchange rate policies. The idea of the developmental state also sits uncomfortably with prevailing political economy models of growth, which emphasize property rights, rule of law, and checks and balances on executive power as key to long-term growth (for example, North 1991; Weingast 1997). States across East Asia did not have many checks on state power, a well-developed rule of law, independent judiciaries, or strong property rights protections.

In the remainder of this Section, I discuss the general features of developmental states as described in the literature. Among these are (1) cohesive, capable, and autonomous bureaucracies; (2) lead agencies responsible for planning, implementing, and monitoring development projects; (3) dense, accountable networks between bureaucrats and businesses; (4) the exclusion and repression of labor; (5) adherence to a transformative and hegemonic development project; and (6) use of industrial policy. I discuss the extent to which each element represents a necessary condition for developmental states. Although I examine each feature individually, the developmental state should be understood as a complex system. In Johnson’s words, “taken together as a system, they constitute a formidable set of institutions for promoting economic growth (a ‘GNP machine’...), but taken separately, as they most commonly are, they do not make much sense at all” (1982, 12).

After reviewing the primary features of developmental states emphasized in the literature, I review debates on why the developmental state originally evolved, focusing primarily on the origins of the archetype in Japan, South Korea, and Taiwan.

⁷ To the extent that Johnson did make a causal argument, it was to say that “credit for the postwar Japanese economic ‘miracle’ should go primarily to conscious and consistent government policies dating from at least the 1920s” (1999, 37).

⁸ Johnson (1999) himself views the developmental state as existing only in Northeast Asia during a specific historical juncture, and not as a more general model.

⁹ It is worth noting that the idea of state-led industrialization is neither new nor original to the developmental state literature. Johnson (1982) locates the Japanese political economy as a descendent of the German Historical School and Friedrich List, who argued that fostering the economic progression from agriculture to manufacturing was the task of the state. The idea that the state should play a leading role in development also featured heavily in Gerschenkron’s (1962) theory of late development, and in Myrdal’s (1968) argument that the lack of “hard” state in developing countries that could overcome vested interests to push transformation was a key cause of underdevelopment.

Characteristics of the Developmental State

Cohesive, Capable, and Autonomous Bureaucracies

First, developmental states are characterized by cohesive, capable, and autonomous bureaucracies that are able to both plan and implement transformative development projects. Johnson (1982) proposed that developmental states needed a meritocratic and professional bureaucracy that was insulated from both the pressures of special interests and the whims of ruling politicians. Meritocratic recruitment to public service was viewed as good not just for promoting competence among bureaucrats, but also for elevating the profession and giving employees a sense of worthiness. Bureaucracies in the archetypal developmental state, Evans argued, feature “organizationally consistent career ladders that bind the individual to corporate goals while simultaneously allowing him or her to acquire the expertise necessary to perform effectively” (1989, 581). Unlike much of the literature on good governance today, the developmental state emphasizes effectiveness rather than efficiency as a primary criterion of a capable bureaucracy. Therefore, evidence of the misuse of funds or overly complicated bureaucratic processes does not necessarily fail to align with bureaucratic capability, as long as the desired policies are implemented effectively.

Further, autonomy from special interests and politicians was seen as a key element of what makes bureaucracies effective. Autonomy is generally understood to mean that bureaucrats are able to override special interests in order to implement transformative development projects. Johnson (1982) saw the role of politicians in the developmental state as acting as a buffer between bureaucrats and special interests. In his formulation, politicians “reign” while bureaucrats “rule,” and the main objective of politicians is to “legitimize the actions of elite bureaucratic agencies” (Onis 1991, 111). An insulated bureaucracy pursuing a transformative and revolutionary developmental project could be more experimental and undoctinaire in its policies and approaches as compared to a typical regime, allowing the bureaucrats to innovate successful approaches and drop unsuccessful ones (Johnson 1999).

However, there is considerable debate about whether any of the developmental states—even the archetypal ones, namely, Japan, South Korea, and Taiwan—ever achieved the bureaucratic ideal. Chang (2010) notes that the East Asian NICs did not begin their development trajectories with high-quality bureaucrats. In the late 1960s, South Korea sent bureaucrats for training to Pakistan and the Philippines, which were viewed at the time as more capable bureaucracies. Further, it wasn’t necessarily the case that bureaucrats implementing economic policies were first-best economists. Most officials running the economic bureaucracies in Japan and South Korea were lawyers by training, while engineers tended to run economic policy in Taiwan and China (Chang 2010). In a critique of East Asia’s institutional conceit, Nunberg (2002) argues that though initial recruitment into bureaucracies did tend to be meritocratic, career advancement often wasn’t and performance was judged based on rule compliance.

Others have argued that bureaucrats also did not have much real autonomy in developmental states. For example, Ramseyer and Rosenbluth (1993) have argued that in Japan, politicians had a high degree of influence over bureaucrats—with the latter being little more than agents of the Liberal Democratic Party. Moon and Prasad (1994) have made similar observations about Korean bureaucrats under President Park. Mkandawire argued that the developmental state literature confuses state autonomy with state capacity. In reality, he argues, what is key is “the ability of the state to persuade key players to adhere to its developmental agenda” rather than insulation from special interests (2010, 72). Indeed, it is strange to think that bureaucrats would enjoy real autonomy in authoritarian political systems. Perhaps what is remarkable about developmental states is their ability to secure bureaucratic loyalty to the developmental project of the authoritarian politicians, and not to seek autonomy from said politicians.

It is also worth noting that many states with significantly lower levels of bureaucratic capabilities have followed the development model of the East Asian NICs, and have still experienced substantial economic growth and structural transformation. China is the most prominent example, but the Southeast Asian “tigers” would fall into this category as well. This puts into question the extent to which it is necessary to possess an idealized version of a high-capacity bureaucracy to pursue a path of state-led development.

Lead Agencies

Second, developmental states have a specific agency that leads the bureaucracy in pursuing the state’s development agenda. From an organizational perspective, Johnson (1982) argues that a pilot organization is needed to lead the cohesive, capable, and autonomous bureaucracy. This pilot agency should control industrial policy and participate in a broad array of policy activities necessary for state-led industrialization, including planning, energy, domestic production, trade, and finance. Ideally, the pilot organization serves as a think tank as well, providing forums for “exchanging views, revising policies, obtaining feedback, and resolving differences” (Johnson 1982, 318). Given the high profile of the agency and its significant role in the development and implementation of policy, it should be staffed with the best managerial talent available.

In Japan, this pilot agency was the MITI, which controlled industrial policy, trade policy, and, until 1979, the allocation of foreign exchange. It served as the inspiration for South Korea’s powerful Economic Planning Board (EPB). The EPB had even more far-reaching powers than MITI. It controlled both planning and spending and coordinated the activities of the Ministry of Commerce and Industry, the banks (which were state-owned between 1961 and 1983), and state-owned enterprises (Jomo 2003c). Malaysia similarly used a lead agency, the Economic Planning Unit (EPU), which reported directly to the prime minister and was responsible for implementing and enforcing development plans.

The idea of a pilot agency to lead reform projects has become broadly influential in the development literature. For example, the World Bank has emphasized the role of “reform teams.” These are small, dedicated teams connected to the top of government and responsible for formulating development policies, building consensus, mobilizing resources toward implementing policies. They also ensure that development agendas are carried out across leadership transitions in developing economies that have managed to sustain GDP per capita growth rates of over 4 percent per year (Criscuolo and Palmade 2008).

Examination of the cases shows that there is no single way to organize a lead agency. While South Korea used a powerful economic planning agency, in Japan the role was played by a line ministry. In Taiwan, the role was played by an institutionally weaker coordinating committee, which was nonetheless influential as an “island of competence” and prestige within the bureaucracy.

Dense, Accountable Networks between States and Businesses

Third, developmental states are distinguished by dense networks between states and businesses, with states able to hold business accountable for performance. States distribute subsidies and incentives to the private sector with the understanding that incentives will be withdrawn if businesses fail to meet expectations. The ability of strong states to hold businesses accountable is key to these relationships. In South Korea, the government gave subsidies but then held businesses accountable “to concrete performance standards with respect to output, exports, and, eventually, R&D” (Amsden 1991, 284).

This did not mean that there was no rent-seeking, but rather that it was constrained. Informed by the East Asian experience, Schleifer and Vishny (1993) provided a model of corruption showing why the strong states in East Asia could give incentives and subsidies to business without the type of unrestrained rent-seeking seen in other regions. In their model, rent-seekers demand government-supplied goods. If governments are decentralized or not cohesive, many individual ministries and officials pursue their own interests and rent-seekers must lobby and bribe a range of different actors. Centralized, cohesive bureaucracies solve this problem by making clear the identity and number of actors that must be bribed,

setting bounds on the overall level of corruption. In this view, the dense business networks were for mutually beneficial bribes and kickbacks between bureaucrats and business elites. The networks promoted growth rather than unrestrained rent-seeking because of the long time horizons of the actors involved (Rock and Bonnett 2004), as well as the overall level of rent-seeking restrained through centralized, institutionalized relationships.

Relationships between states and businesses were forged through “deliberation councils” that helped to forge trust between government and business. Evans (1989) introduced the concept of “embedded autonomy” to describe these business-state networks. Essentially, alliances of political elites, bureaucrats, and private-sector actors facilitated the flow of information and reduced uncertainty for firms, helping to solve collective action and coordination problems. Ideally, these alliances allowed bureaucrats and firms to work together to address obstacles to facilitate investment.¹⁰

Trust and positive associations between states and firms matter for early industrialization, because the government and the private sector depend on each other to make productive and complementary investments. To jump-start industrialization, the government must invest in infrastructure and education, and the private sector must make risky investments in new sectors. Huff, Dewit, and Oughton (2001) describe state-private sector relations in a developmental state as a dynamic game where each player must make simultaneous investments in order to achieve growth. This is based on the idea that a state that invests in productive activities but fails to convince the private sector to do the same will not reap the benefit of its investments. Similarly, a firm that invests in new sectors without complementary government investments in infrastructure, health, and education stands little chance of profiting. Thus, convincing private actors of the government’s credibility—through its intentions to make complementary investments and to not expropriate from businesses—is key to initiating industrialization. Collaborative networks between states and businesses may help to overcome these credibility problems.

However, embedded autonomy requires a careful balance: by this account, bureaucrats interact collaboratively with business interests but are not captured by them. Even if there is some corruption, it does not cross some optimal threshold. In reality, relationships between bureaucrats and business could as easily be painted as “crony capitalism” (Kang 2002). Moreover, these state-business “deliberation councils” are documented in the cases of Japan and South Korea but are less prevalent in other developmental states. For example, they were absent in Taiwan (World Bank 1993). Evidence is thinner in Southeast Asia, where countries lacked the ability to discipline businesses. Deliberation councils were not implemented in Malaysia until 1991, well after much of its astounding growth had been achieved, and they were part of the overall system of corruption and cronyism that existed between businesses and the state.

Exclusion of Urban Working Class

Fourth, the corollary of developmental states’ dense networks with the producer class was their general exclusion of the urban working class from ruling coalitions. In other words, ruling coalitions were generally narrow rather than broad, and most of the regimes in the region (with the exception of Japan) were authoritarian or semi-authoritarian. While many developmental state writings have glossed over the authoritarian nature of developmental states, others have argued that narrow coalitions have been an asset to developmental states. For one, growth requires capital accumulation, which in turn requires that resources be diverted from consumption to investment, a prospect that may be unpopular with poorer voters. Although Johnson denies a direct connection between developmental states and authoritarianism, he acknowledges that authoritarianism can help states to “solve the main political problem of economic development using market forces—namely, how to mobilize the overwhelming majority of the population to work and sacrifice for development projects” (1999, 52). Dictators may also have advantages in pushing through initially unpopular economic reforms (Haggard 1990).

¹⁰ Unlike corporatist arrangements in Europe, the East Asian versions did not include labor or other social groups.

However, exclusion of the working class was more than a political convenience. A key problem among late-industrializing economies is how to maintain international competitiveness. This must be accomplished while experiencing industrial expansion driven by rising labor productivity, yet maintaining low labor costs that continue to attract investments (Amsden 1991). Thus, keeping wage increases below increases in labor productivity was a key principle of the economic strategy in developmental states.

Wage suppression was achieved in many states through direct and indirect control of labor, including through the use of mass repression. Repression enabled “private investors to have a ready supply of cheap, ‘flexible,’ and disciplined labor” (Kohli 2004, 13). However, in many developmental states, the states that did went far beyond repression of labor. In South Korea, the Rhee regime utilized the massive police force of 60,000—one for every 400 Koreans—to systematically and violently root out leftists from the country, instituting a massive “re-education” program that led to the arrests of about 300,000 people (Vu 2007). When Park Chung-hee seized power through a 1961 coup, he made labor unionization and assembly strictly illegal (Kim 2010). South Korean workers attempted to organize many times, even though they faced constant harassment and repression.

However, not all states utilized labor repression to maintain low wages in the industrial sector. Hong Kong and Singapore utilized migration as a means of countering rising wages. The states also provided heavily subsidized housing and welfare services to keep costs low for workers. Agricultural policies also played an important role in maintaining low wages. South Korea enacted price controls to provide industrial workers with cheap food, lowering the wage bill for manufacturing firms (Jomo 2003c).

Transformative and Hegemonic Developmental Goal

Fifth, a transformative and hegemonic developmental goal is regularly cited as a key feature of developmental states. Johnson (1982) termed this the “binding agent” for development. In Japan, he argued, a revolutionary nationalism that grew out of war and imperialism motivated the developmental elite and helped them bring firms and citizens into the national development project. For Johnson (1999), the experience of war in Asia defined the world view of the bureaucrats serving in MITI during the era of Japanese transformation. This transformation motivated the single-minded pursuit of development to catch up with the United States and Western Europe. Similarly, in South Korea, the civil war and the rejection of communism, as well as exiting the Japanese colonial experience, were strong motivations. Woo-Cumings notes that the pursuit of economic growth pervaded the state and its citizens: “a talismanic double-digit Gross National Product (GNP) growth figure... was the Korean score in the race to catch up with Japan and also to surpass the DPRK’s [North Korea’s] economic performance” (1991, 98). Most often, Woo-Cumings (1999) argues, a strong sense of nationalism animates the transformation project.

It is not just that developmental states have a hegemonic, transformative development project—the type of project is also important. And, despite the considerable success of developmental states in the export market, producing exportable goods was not the end goal; it was an emphasis on the development of the domestic market as the source of long-term economic growth. Johnson (1982) emphasizes this point particularly in the Japanese case, with its use of tax cuts and fiscal policy to open up domestic demand, which he argues was the driving force in economic growth rather than export sales.

As with other features of developmental states, scholars have also taken issue with the idea that economic transformation was achieved through a singular adherence to a grand development strategy. For one, nearly all states purport to be developmental, so distinguishing between those with more or less authentic and transformative goals is a subjective exercise. Moreover, even the adherence of East Asian NICs to a single transformative goal may be overestimated. For South Korea and Taiwan, Cheng (1990) argues that ad hoc policy changes, processes of trial and error, and compromises characterized policy making more than did adherence to a single grand strategy. In Japan, Morishima (1984) notes, there was never a definitive map for how to achieve industrialization but rather processes of trial and error characterized the approach. There is a tendency to mythologize the East Asian NICs as noncorrupt bureaucracies with grand development strategies, Mkandawire argues, when their developmental states

and visions were actually “built over many years by trial and error, intelligent emulation and borrowing, new country-specific innovation – and even luck” (2010, 78).

Use of Industrial Policy

Finally, developmental states are distinguished by what they do. Namely, their use of industrial policy, or targeted government support, for particular industries, firms, or sectors aimed to achieve outcomes that the state perceives to be efficient for the economy as a whole.¹¹ On a basic level, industrial policies can promote investment in new (and risky) economic activities by underwriting risk and financing losses that are sustained before firms become competitive in the new activities. In the debate about the causes of the East Asian miracle, the role of industrial policy has been one of the most contentious issues. The East Asian NICs and Japan have used a wide array of industrial policies. These include: (1) infant industry protections, (2) export promotion through export subsidies, (3) assistance with marketing for exports, (4) coordination of complementary investments, (5) regulation of firm entry and exit, (6) regulation of pricing intended to manage competition, (7) subsidies intended to encourage technological upgrading, and (8) establishment of state-owned enterprises intended to invest in high-risk and large-scale industries (Chang 2006).

While it is difficult to deny that East Asian countries made extensive use of industrial policies, it is heavily debated whether these policies played a significant role in their growth. Notably, a prominent World Bank report concludes that “industrial policies were largely ineffective” in changing the sectoral structure of the economy or in affecting rates of productivity change (1993, 312). This conclusion is drawn on the basis that the industrial structure in the East Asian NICs was largely “market-conforming”; in other words, industrialization in these areas would have proceeded along the same lines even in the absence of industrial policy. In a scathing critique of the report, Amsden (1994) notes that this line of thinking makes it impossible for industrial policy to ever be counted as successful, since it is deemed inefficient if it does not conform with market principles and ineffective if it does. On the other hand, Haggard (2004) points out that many studies of industrial policy in East Asia have examined only successful industries and sectors; these studies demonstrate that industrial policy existed and then conclude that the policy led to the success. He notes that among studies that have gathered data from a wide range of sectors within a country—not just the successful ones (for example, Noland and Pack 2003)—evidence that industrial policy played a major role in shaping which sectors experienced the greatest increases in productivity and export shares is thin.

Overview of Developmental State Characteristics

Table 2.1 summarizes the main characteristics associated with developmental states and some of the sources of debate about each feature. While there is general agreement about the characteristics of an ideal developmental state, what is notable is how little agreement there is about whether even the archetypal cases of Japan, South Korea, and Taiwan fit the set of supposedly necessary characteristics. Even less clear is which of these conditions are necessary and/or sufficient for a developmental state model to succeed elsewhere.

¹¹ This definition is the one used by Chang (2006). Throughout the literature review, I refer to industrial policy in this specific way, which does not include other policies that the state can implement that may also affect industrialization, such as educating the workforce.

Table 2.1 Characteristics and discussion of developmental states

Characteristics of the developmental state	Criticisms, discussion, and outstanding questions
Cohesive, capable, and autonomous bureaucracies	<ul style="list-style-type: none"> • East Asian NICs did not begin with capable bureaucracies; these were developed over time. • Bureaucracies were not always autonomous, even among East Asian NICs. • China and Southeast Asian “tigers” have also pursued state-led development with lower levels of bureaucratic capability.
Lead agencies	<ul style="list-style-type: none"> • Lead agencies play an important role in most developmental states, but provide no single blueprint of how the agency should be organized (for example, as a planning agency, a line ministry, or a coordinating committee).
Dense, accountable networks between states and businesses	<ul style="list-style-type: none"> • There is a careful balance between collaboration between states and business and “crony capitalism” and corruption. • Why did state-business links promote growth in East Asia and rent-seeking elsewhere?
Exclusion of the urban working class	<ul style="list-style-type: none"> • Because state-business alliances sought to keep wages low, workers were excluded—often through the use of force and repression—from ruling coalitions. This raises questions about whether the developmental state model is compatible with democracy.
Transformative and hegemonic developmental goal	<ul style="list-style-type: none"> • Most states claim to be developmental, so it is difficult to assess which states’ goals are more “authentic.” Any assessment is likely subjective. • East Asian NICs are characterized more by trial and error than by single-minded adherence to a developmental goal.
Use of industrial policy	<ul style="list-style-type: none"> • Industrial policy was widely used across East Asian NICs—and across many developing countries in other regions as well—but it is difficult to assess the causal role played by widely divergent industrial policies across different countries with different institutions and historical and social conditions

Source: Compiled by author.

3. WHY DO DEVELOPMENTAL STATES EMERGE?

Most studies of developmental states in East Asia have focused on the 1960s through the 1980s, when industrialization was effectively launched and economic growth began in earnest. But beginning with the institutions in place in the 1960s misses the potentially deeper causes of the developmental state itself. Why did East Asia develop strong institutions in the first place? As Haggard (2004, 56) aptly put it, “the preoccupation with institutions ... has obscured more fundamental political and social processes that are themselves determinants of institutional form and quality”. Further, understanding why developmental states emerged in Northeast Asia and not elsewhere has implications for whether the developmental state model can be replicated elsewhere, in countries with different historical legacies and social conditions.

In what follows, I briefly review the most commonly cited historical conditions that led to the emergence of developmental states: the legacies (or lack thereof) of colonial institutions, the extensive land reforms undertaken in the aftermath of the Second World War, the resource base of the state, and the role of internal and external security threats in regime consolidation. Numerous historical conditions are emphasized in explanations of why certain states have become developmental; the explanations reviewed here are not necessarily alternative to each other, mutually exclusive, or exhaustive. Indeed, Pempel has argued that “numerous forces triangulated to make the isolation of some single, super cause [of the East Asian growth miracle] all but impossible” (1999, 138).

Explanations for the Emergence of Development States in East Asia

Colonial Legacies

Many scholars have argued that colonial legacies play a prominent role in later development trajectories (for example, Acemoglu, Johnson, and Robinson 2001; Banerjee and Iyer 2005; Mahoney 2010). Indeed, it is crucial to understand the very different historical foundations of state building across Northeast and Southeast Asia in order to understand current development efforts.

Two quite different perspectives emerge when considering the effect of colonialism on East Asian development. On the one hand, many states in East Asia—including Japan, China, Korea, Taiwan, and Thailand—experienced minimal (or no) colonialism compared with other developing regions. Korea and Taiwan were colonized by Japan for a relatively brief period in the early 20th century (for 35 years and 50 years, respectively). These countries were primarily governed by local rulers through local institutions, meaning that by the middle of the 20th century, when many former colonies began to gain independence from colonial powers and rule themselves for the first time in generations, many areas of East Asia already had significant experience in self-governance. Upon independence, developing countries in other regions often had to contend with arbitrary borders drawn by colonial powers, leaving them with populations divided by ethnicity and language and the difficult task of uniting diverse populations and addressing contested borders. By contrast, the nations of Northeast Asia did not have major border disputes or deep conflicts over ethnicity and language; instead, they had a millennium or more of shared history and culture. While having common language, undisputed borders, and experience with self-governance by no means guaranteed economic development, these factors may have simplified the tasks facing leaders in Northeast Asia relative to new leaders in other areas of the world (see Perkins 2013, chapter 1).¹² From this perspective, many states in East Asia, particularly those in Northeast Asia, could be viewed as “blessed” by the relative lack of colonialism compared with other regions.

¹² The Korean War may have further homogenized the population: during the civil war the population “sorted,” with the Christian minority formerly living in the north moving south and communists, who would have been key opposition groups to regimes in the south, moving north.

Colonial history in Southeast Asia, by contrast, more closely mirrors that of other developing countries (with the exception of Thailand, which was never colonized). Most government jobs in these areas, with the exception of village institutions, were held by Europeans, meaning that few had experience in self-governance upon independence. Borders across Malaysia, Indonesia, and the Philippines were largely drawn by colonial powers. Territorial issues have affected Indonesia and the Philippines, while conflicts with ethnic minorities have been at issue in Myanmar and Malaysia. Still, as compared to Sub-Saharan Africa, states in Southeast Asia were drawn relatively early in history, giving them a chance to solidify, and the states established common languages relatively early as well (see Perkins 2013, chapter 1).

Others have examined the colonial histories in East Asia and come to quite different conclusions. Rather than point to the relatively brief colonial experience in South Korea and Taiwan compared with other regions, they point to the Japanese colonial experience as key to the origins of developmental states. Japan colonized Korea for 35 years, between 1910 and 1945. Kohli (2004) argues that Japanese colonialism laid the foundation for the developmental state in South Korea and Taiwan through its policies of building strong and coherent bureaucracies, developing strong ties to the private sector, and utilizing repression to deal with class challenges from below.

Rather than focusing on the institutional legacies of Japanese colonialism, Vu (2007) emphasizes the coercive apparatuses that the Japanese left behind in Korea—and how later political leaders decided to utilize coercive power—as the key legacies of the colonial period for subsequent development. When the Japanese empire collapsed at the end of the Second World War, Japan left a police force of 60,000—one for every 400 Koreans—intact in Korea (Vu 2007). The police force was unpopular as collaborators with Japanese colonialism. The Korean National Assembly even passed a law to purge the bureaucracy and the police of all those who had collaborated with Japanese colonizers. President Rhee, however, intervened to preserve the police force. Thus, he preserved the coercive apparatus of the state developed under colonialism that would later be used to repress labor strikes and mass organization against the state. Rhee further expanded the coercive power of the state during the Korean War, when the size of the Korean army expanded sixfold to a final total of around 600,000 soldiers at the end of the war (Vu 2007). This coercive capacity was used to centralize power and to repress labor strikes and rural uprisings. Although the police force was initially inherited from Japanese colonialism, it was how later political leaders utilized this force that shaped the country's development trajectory.

Vu (2007) contrasts these conditions with those of Indonesia, where the Dutch colonial army was disbanded. During the Japanese occupation of Indonesia, rather than creating a consolidated national police force, Japan created local militias, which they disbanded at the end of the Second World War. These militias returned to their hometowns and became local strongmen who could challenge the power of the central government. Thus, as compared to the Korean government, the Indonesian government did not have the option of mass repression upon independence.

Although Vu (2007) emphasizes colonial legacies in the origins of the institutional structure and coercive power of developmental states, ultimately it is national leaders who decide to take on developmental roles and pursue pro-growth policies. South Korea, following its independence, illustrates this point well. While the Rhee regime played a large role in maintaining and expanding coercive apparatuses inherited from Japanese colonialism, it did not pursue economic development. It wasn't until the Park regime came to power that the institutional structures first put in place under Japanese colonialism and solidified under Rhee were used to promote economic development.

While it is hard to deny the importance of colonialism in shaping developing trajectories, placing too much emphasis on colonial legacies raises as many questions as it answers. How do we reconcile the enduring legacies of colonial institutions with variations in growth experiences? Korea was poorer than much of Southeast Asia during the colonial period. Its end was economically disastrous—between 1945 and 1950, per capita income in Korea dropped by around 25 percent (Kim 2009)—as was its first postcolonial decade (Haggard, Kang, and Moon 1997). Focusing too much on structural explanations for the emergence of developmental states overlooks the roles that local agents play in consciously shaping and reshaping institutional arrangements and in crafting development strategies to suit institutional

arrangements (Leftwich 2010). Institutional theories focusing on colonial origins of institutions also lack a theory of political and institutional change: how and why, for example, did state capacity in Malaysia and Indonesia increase over time, to the point of making industrial growth possible?

Land Reforms

Perhaps one of the most remarkable of the historical and social conditions that laid the groundwork for future developmental states was the massive land reform initiatives undertaken across Northeast Asia in the immediate postcolonial period. For this reason, Kim (2009) argues that what made Korea and Taiwan unique was their dramatic rupture from Japanese colonial institutions as compared with the continuity of colonial institutions in other developing countries. Whereas many developing countries preserved the wealth of the colonial elite and adopted institutions to perpetuate social and economic inequalities instituted under colonialism, Korea and Taiwan broke down these inequalities. Land reform was also undertaken within Japan before the developmental state period. Thus, Korea, Japan, and Taiwan all underwent significant land reform before industrialization (Kuznets 1988), resulting in low levels of dispossession and a remarkably egalitarian income structure.

In Japan, the United States sponsored the breaking up and redistribution of *zaibatsu* industrial conglomerates, which were thought to have contributed to the Japanese military-industrial complex leading up to the Second World War. To ensure popular acceptance of the policy, employees were given first preference for the assets being sold off, followed by local communities, forming the foundations of a stakeholder economy in Japan (Jomo 2003b). In Korea and Taiwan, the Japanese had already displaced many of the landed elites during the colonial period. Japan's landlords in their colonies were wiped out during its defeat in World War II. Further, the fact that Taiwan's ruling party had already lost power to a peasant revolution and that South Korea remained highly sensitive to the dangers of communism after the Korean War put land reform on the agendas of the newly independent states (Evans 2010). In South Korea, about half of total farmland was transferred to the beneficiaries of land reform, and two-thirds of farming households received land under the reform (Kay 2002). In Taiwan, reforms were equally transformative: Under the Land-to-Tiller Act of 1953, landlords were obliged to sell all tenanted land above three hectares to the government, who then proceeded to sell the land back to tenants at a reduced price (Kay 2002). Through this policy, the agrarian structure transformed from one of tenant farmers to one of owner-farmers. Further, the government compensated landlords by giving them shares in state-owned industrial enterprises or government bonds that could be used to invest in new business ventures, giving them a direct stake in industrial activity.

These reforms had several important effects, which may have helped developmental states to evolve. First, they greatly reduced inequality, which many argue is detrimental to long-term growth. Alesina and Rodrik (1994) and Persson and Tabellini (1994) have argued that initial inequality is bad for growth because of the effects that inequality has on political institutions. Low levels of inequality reduce the pressure to engage in redistributive policies that dampen economic incentives to accumulate wealth, which in turn reduces growth. In line with these arguments, Rodrik (1995) attributes about 90 percent of Korea and Taiwan's growth experience to the low initial levels of inequality, a direct result of the massive land reforms.

Second, land reforms transformed the agricultural economy from one based on landed elite and landless laborers to one based on smallholder farmers. When agriculture is dominated by landed elite and landless laborers, there are few incentives to invest in human capital or improvements in agricultural productivity. By contrast, a broader distribution of property rights along with smallholder production can mean improved farm efficiency, as small farms are often more efficient than their larger counterparts in developing countries.¹³ This, in turn, can raise rural incomes and lead to the expansion of domestic demand.

¹³ See Heltberg (1998) for a review.

The corollary of greatly expanding land ownership for smallholders was the elimination of the landed elite. A vast body of literature associates landed, agrarian elite with resistance to industrialization. This was the basis of Gershenkron's (1970) argument that to a great degree, the question of why industrialization varies across countries is related to the question of why elites promoted industrialization in some countries but not others. Agrarian elites are particularly likely to block industrialization because they risk losing political power: the rise of markets and industrialization is associated with a shift in power away from traditional, land-holding elite and toward industrial interests. Acemoglu and Robinson (2006) call this the "political replacement effect." The landed elite will block innovation and industrialization if they fear being politically replaced in the new industrial order. Elimination of the agrarian elite through massive land reforms thus removed a key constituency with the incentive to block industrialization.

Third, there was a darker side to the land reforms, often glossed over in discussions of East Asian success. While the reforms greatly expanded ownership among smallholders, it also expanded the state's control over the countryside and facilitated a massive transfer of resources out of the agricultural sector. After reforms, farmers in Taiwan were subject to new taxes, higher prices on agricultural inputs, and lower prices on agricultural products; essentially, the state replaced landlords in extracting surplus from the countryside. The state used its enhanced position to keep rice prices low—in turn, keeping industrial wages low—and to use monopolistic procurement methods to acquire sugar and rice. The export of these products generated foreign reserves for the state to use toward importing machinery and equipment for industry. Enhancements in agricultural productivity were often achieved through coercion; police were sometimes used as agricultural extension workers to compel peasants to adopt new technologies (Apthorpe 1979; Kay 2002).

In South Korea, land reforms similarly enhanced the state's command over the countryside. The state established a monopoly over agricultural inputs, including fertilizer and credit, forcing farmers to negotiate with local but centrally appointed bureaucrats who could determine input prices and sales prices for agricultural products. Industrialization was largely financed by extracting surplus from the countryside, meaning that despite improvements in agricultural productivity there was limited improvement in standards of living in rural areas. This no doubt motivated the mass rural-to-urban migration that helped South Korea provide the cheap labor necessary to expand labor-intensive industries (Kay 2002).

By comparison, land reform across Southeast Asia was less redistributive and transformative but also involved less coercion. In Malaysia and Thailand, new lands were opened up to reduce dispossession rather than redistribute ownership rights over existing lands. In Malaysia, this method was reasonably successful at expanding ownership, affecting about 15 percent of the rural Malay population and bringing about half a million people into smallholder palm oil and rubber agriculture (Kuhonta 2011). In Thailand, efforts were substantially less successful; by 1988, 15 percent of the country's total population were squatters without any property rights (Christensen and Rabibhadana 1994). The state encouraged expansion into public reserve forests and illegal land clearing as a means to increase ownership, rather than actually redistribute property rights or reduce the number of dispossessions.

Although land reforms were much less extensive, the overall orientation of agricultural policy was less coercive for smallholders in Southeast Asia as compared with those in South Korea and Taiwan. In their analysis of agricultural policies across Southeast Asia, Booth et al. (2015) emphasize economic freedom for smallholders—the freedom to choose crops and to reap the profits from their efforts—as a key aspect of agricultural policy in the region.

It is also worth noting that Japan, South Korea, and Taiwan may be outliers in the growth-enhancing effects of large-scale land reform. Albertus (2016) notes that the majority of large-scale, equalizing land reforms—such as those in East Germany, Vietnam, North Korea, Ethiopia, Tanzania, Zimbabwe, and Cuba, among others—have stifled growth over the long term. He argues that the divergent outcomes are attributable to whether large-scale land reforms also come with private property protection, as they did in Japan, South Korea, and Taiwan. In other cases, large-scale land reforms have tended to provide beneficiaries land with collective or state ownership or land with no titles at all.

In summary, land reforms brought about remarkably high levels of equality and low levels of dispossession. This helped to lay the groundwork for developmental states in Japan, South Korea, and Taiwan. Yet, the less transformative but less coercive paths forged by developmental states in Southeast Asia may provide a more desirable model for developing states today.

Resource Base

Others point to states' revenue base—or lack thereof—as key to the origins of developmental states. Two sources of state revenue have been noted as particularly important in shaping the development of state capacity: natural resource revenues and foreign aid.

As noted by Doner, Ritchie, and Slater (2005) and Doner (2009), it was the lack of access to resource revenues that motivated elites in East Asia to pursue development. Faced with external and internal security threats to their rule, elites needed to generate resources to deliver side payments to their challengers. Lacking the ability to raise revenues by taxing natural resources, elites in resource-poor South Korea, Taiwan, and Singapore urgently pursued industrialization as a means of raising the revenues they needed to stay in power. To do so, they had to build state institutions capable of promoting industrialization. By comparison, leaders in resource-rich Southeast Asia did not face similar exigencies to industrialize, since elites could gain access to easily taxable resource revenues (Booth 1999).

Emphasis on resource constraints as a motivating factor in building state capacity in East Asia mirrors the “resource curse” literature. The resource curse is the counterintuitive idea that states are cursed rather than blessed by natural resource wealth. One curse associated with resource wealth is the idea that, because of their high visibility, natural resource revenues are comparatively easier to tax than other forms of income. Thus, politicians with access to this form of revenue can fulfill popular demands without ever assembling strong state institutions typically necessary for revenue collection.¹⁴ In a similar vein, scholars have argued that access to foreign aid diminishes incentives to build state capacity to collect domestic tax revenues (for example, Remmer 1994; Brautigam and Knack 2004).

However, there are several problems with attributing the origins of state capacity to resource constraints. For one, the role of natural resource wealth, or lack thereof, in the development of state capacity is complex and hardly deterministic. If resource wealth were straightforwardly associated with reduced state development, then Malaysia would be among the weakest states in the region and Cambodia among the strongest (Larsson 2013). Indeed, Jomo (1997) notes that resources wealth facilitated growth within Southeast Asia—rather than the reverse—by financing infrastructure development, expanding education and health care services, and enabling strong macroeconomic fundamentals (for instance, avoiding balance of payment problems).

Additionally, South Korea and Taiwan were hardly resource constrained. In the wake of the Second World War, they received large sums of economic and military aid from the United States. In Taiwan, the U.S. aid program between 1951 and 1965 played a major role in providing industrial goods, plants, and equipment, which amounted to 10 percent of Taiwan's GNP in 1951 (Vogel 1991, 21). Food aid played an important role in the 1960s in South Korea, enabling the country to import large quantities of free or cheap food from the United States and keep costs of labor low. The United States strongly supported strong, centralized states in East Asia as a bulwark against the spread of communism (Cumings 1984) and, in addition to extensive economic and military aid, was willing to open its markets to East Asian manufactured imports. The United States also paid inflated prices for raw materials and industrial products needed to fight wars in Korea and Vietnam, a major factor in expanding demand for East Asian exports (Stubbs 2005).

¹⁴ Doner, Ritchie, and Slater (2005) and Doner (2009) extend this framework through their emphasis on how security threats and resource constraints interact. The role of security threats—internal and external—will be discussed.

Rather than suffering from resource constraints, then, South Korea and Taiwan benefited from relatively free-flowing US capital. A distinguishing feature of US foreign aid in the aftermath of World War II was that it was channeled directly through states: channeling aid through states had “given governments a tremendous advantage when dealing with the major societal players in their respective economies,” and enabled them to use aid as a means of strengthening and centralizing the state (Stubbs 2009, 11). By contrast, channeling large sums of foreign aid directly through states has been much rarer since the end of the Cold War (Kyle and Sperber 2015). Instead, foreign aid is often channeled through civil society organizations and spread across a multitude of smaller projects, potentially contributing to political fragmentation rather than consolidation. How aid shapes state capacity may depend on how it is channeled and how local elites respond to and utilize the capital flows. In other words, local agency rather than structural conditions likely condition the impact of the resource base. The role of foreign aid and natural resource revenues in the emergence of developmental states is a promising topic for future research.

Security Threats

Scholars have also pointed to security threats as a catalyst for the emergence of developmental states. The idea that threats to security propel the development of strong states was famously developed by Charles Tilly in *Coercion, Capital and European States* (1990). He argues that the demands of preparing for war—and the need to extract resources from society to finance it—motivated the creation of modern states with strong, centralized bureaucracies. In a similar vein, scholars have emphasized that the severe security threats faced by East Asian states in the aftermath of the Second World War compelled leaders to develop strong, centralized states (for example, Woo-Cumings 1998; Campos and Root 1996). Indeed, the fact that both South Korea and Taiwan were “born of civil wars” shaped the outlooks of their leaders and the urgency with which they approached economic development (Woo-Cumings 1999,10). The threat of communism drove leaders to pursue economic development as a hegemonic project; this threat raised the pressure on leaders to succeed in development projects because failure was seen as inviting revolution and political upheaval (Zhu 2002). Still, developmental states scholars offer little guidance on why external threats should lead to state-building in East Asia, when in other regions they have been associated with building up military forces without any concomitant emphasis on building state capacity.

Doner, Ritchie, and Slater (2005) propose a more contingent view of how security threats shape the emergence of developmental states. They argue that a specific set of factors must exist in combination to bring about developmental states, or what they call “systemic vulnerability.” These factors are: (1) a need for the resources and foreign exchange required to deliver side payments to an agitated popular sector—an internal security threat, (2) the necessity to simultaneously protect the state under conditions of geopolitical uncertainty—an external security threat, and (3) the lack of an easy means of obtaining resources and foreign exchange— for example, natural resources and foreign aid. Doner, Ritchie, and Slater (2005) argue that South Korea and Taiwan faced conditions of “systemic vulnerability” while Malaysia, the Philippines, and Indonesia did not, explaining their less impressive levels of state-building.

However, like many of the other historical and social conditions associated with the emergence of developmental states, security threats—even systematic vulnerabilities—do not systematically lead to state-building efforts. Rather, security crises may present elites with a crossroads at which several different strategies can be pursued, one of which is institutional strengthening (Kuhonta 2011).

Postwar Trade Environment

Another factor said to contribute to the industrialization of the East Asian NICs was the favorable economic and trade conditions after the end of the Second World War. The postwar economic boom in the United States in particular led to an expansion in international trade and increasing opportunities for export-led growth. Under the General Agreement of Trade and Tariffs (GATT), the Generalized System of Preferences afforded developing countries exemptions from import duties into developed countries.

While benefiting from the favorable international trade environment, the East Asian NICs faced few pressures to liberalize their own economies or to enforce intellectual property rights protections. This enabled them to pursue technology transfers and maintain protections for domestic industries for extended periods. This tolerance was motivated by the important role that South Korea and Taiwan in particular played as Cold War allies of the United States (Hayashi 2010). As noted above, the strategic position as U.S. allies in the Cold War provided other benefits as well, including large influxes of foreign aid.

On the one hand, it is hard to deny that the East Asian NICs benefited from the boom in international trade after the Second World War and the relatively liberal trading environment. Slowed economic growth in developed countries has afforded fewer opportunities for export-led growth during later decades. In addition, as argued by Wade (2003), increased pressure to liberalize and open economies has limited the “development space” for developing countries to protect emerging industries. On the other hand, Chang argues that there was not as much policy freedom as is assumed during the GATT era, and that World Trade Organization constraints on developing country policies are not as “widespread and binding as they are usually made out to be” (2006, 51). In any case, in assessing the relative success of East Asian development, it is important to take into account the opportunities afforded—or not afforded—by the international economic environment as a facilitating, or binding, factor.

Political Settlement

Perhaps the most fruitful explanation of the emergence of the developmental states is simply the idea that policies are chosen as a means of staying in power and expanding political support. The development approach can be explained by understanding the nature of the ruling coalition that supports ruling elites, the vulnerabilities and threats they face, and the resources they can access to face those threats and maintain power. Indeed, this is the idea underlying the argument for why security threats and resource constraints motivate regimes to expand their capabilities (Doner, Ritchie, and Slater 2005; Doner 2009).

Scholars have introduced the idea of “political settlements” to help explain how different coalitions affect the incentives of the state and the functioning of its institutions. Institutions work differently in different political contexts. Specifically, a “political settlement” underpins institutions. A country’s political settlement is the “combination of power and institutions that is mutually compatible and also sustainable in terms of economic and political viability” (Khan 2010, 4). A political settlement must be mutually compatible. If a powerful group in society does not receive a distribution of benefits from current institutions commensurate with their power in society, they will use their power to reshape institutions. Khan (2010) argues that political settlements must also be sustainable in the sense that they can provide a minimum level of economic performance and political stability; otherwise, they risk being overthrown. Political settlements can change over time, as “there is a feedback loop between the cumulative outcomes of industrial policy and the country-specific political settlement” (Whitfield et al. 2015, 25). The effective of industrial policy on the power of different social groups will play a major role in the Malaysian case study in Section 6.

Overview of Developmental State Emergence

Whether scholars point to the legacies of colonial institutions, the role of land reforms, the resource base of the state, or security threats as the sources of developmental states, a common theme is the tendency to explain the unusually strong states in East Asia as the product of structural conditions. However, it may be equally important to look for explanations rooted in the agency of local actors (Leftwich 2010). Why has Myanmar not been able to forge developmental institutions, despite the obvious security threats and resource constraints it has faced? Why have some political elites broken with colonial institutions while others have perpetuated them? Why have some countries pursued different pathways to agrarian reform? In the following section, I take a step back and examine developmental outcomes across the region, identifying key differences in development trajectories. Section 5 provides a framework that builds on the developmental state literature. It is designed to explain the more nuanced developmental outcomes defined in Section 4.

4. COMPARING DEVELOPMENTAL OUTCOMES ACROSS EAST ASIA

There is surprisingly little consensus in the developmental state literature on what exactly constitutes “development.” Whereas many of the first discussions of developmental states focused primarily on economic growth, later examinations emphasized inclusive growth (that is, growth with equity) as the hallmark of the East Asian miracle (for example, World Bank 1993). Others have prioritized structural transformation and upgrading as the most relevant indicators of development (for instance, Doner 2009; Doner, Ritchie, and Slater 2005). More recently, Evans (2010) has proposed a “21st century developmental state” that uses enhancements in human capabilities as the basis for development success. In general, the tendency over time has been to expand the economic and social goals of the developmental state, from economic growth, to structural transformation, to a vision of development that puts equal weight on economic and social goals.

Defining the outcomes that constitute development is vital when examining the role of the state, which may differ dramatically across outcomes. A minimalistic state role of providing law and order, contract enforcement, and protection of private property—such as that emphasized in the institutional economics literature—may suffice to encourage investment and economic growth in some contexts. However, when the development goal is broader and more transformative, such as structural transformation of the economy or broad-based, inclusive growth, states may need to take a more active role in development. This would entail going beyond restraining negative state behaviors (for example, rent-seeking) to take on positive roles in development.

Moreover, development goals may be in tension with one other, a fact rarely acknowledged in the literature. For example, the institutions that can be harnessed to overcome collective action problems to achieve structural transformation and upgrading of the economy may be poorly suited to broad-based, inclusive development (and vice versa). Taking into consideration potential trade-offs in pursuing development goals goes against the general idea, pervasive in the development literature, that all good things go together.

In addition to differences in emphasis on different development outcomes, the literature is divided on which sets of countries should be compared to define success. These differences have significant implications for Southeast Asia in particular. Within-region studies tend to explore why the East Asian NICs—South Korea, Taiwan, Hong Kong, and Singapore—outperformed other parts of East Asia despite similar starting points. For instance, why did Southeast Asia lag behind the East Asian NICs, particularly in the upgrading of the economies? By contrast, cross-regional studies examine why East Asia as a whole outperformed other regions of the world, including Sub-Saharan Africa and Latin America, despite the fact that the regions began with similar per capita incomes and, in the case of Latin America, higher levels of initial industrialization.

While there is consensus across these perspectives on the high performance of the East Asian NICs, perspectives on the performance of Southeast Asia differ dramatically. On the one hand, Southeast Asia did not grow as much as the NICs, nor did its economies upgrade as extensively. On the other, Southeast Asia—in particular, Malaysia, Indonesia, and Thailand—has experienced substantially higher growth rates compared with developing countries in other regions. As such, Southeast Asia is frequently cited as a development pathway worthy of emulation by other developing countries today (for example, Booth et al. 2015; World Bank 1993). This tension about whether to see Southeast Asia as a relative failure or a relative success—or something in between—appears throughout the developmental state literature.

This section provides a broad overview of regional developmental outcomes, including economic growth, structural transformation, upgrading, equity, and capability enhancement. I focus on whether and how development outcomes track together without assuming that all positive outcomes flow together, and note explicitly where they have not. I provide perspective on the development achievements of Southeast Asia in particular in relation to other states in the region as well as to developing countries in other regions. Only a broad overview is provided here; many of the detailed statistics are provided in the appendix.

Growth, Transformation, and Upgrading

Fundamentally, the hallmark of the East Asian economic miracle has been the astoundingly high levels of economic growth achieved by many states in the region since the 1960s, despite initial incomes not much higher and, in some cases, substantially lower, than those in other developing countries. Because much of the GDP data begins in 1960, this is often the starting point of discussions of the East Asian growth miracle. Less discussed, but vital to understanding the region's history, is the amount of wealth lost across East Asia during and in the aftermath of the Second World War. Between 1930 and 1950, per capita income dropped nearly 60 percent in Myanmar, 25 percent in South Korea, and 28 percent in the Philippines (Kim 2009). In Indonesia, during the war over 3 million citizens died during on the island of Java alone, and per capita income declined by 28 percent. Despite the remarkable growth rates in South Korea, it took nearly a decade for it to return to its prewar income levels. In many ways, these events make the growth rate even more notable and more comparable to developing countries today that may themselves be emerging from conflict.

From an initial income of \$1,106 in 1960—roughly the per capita income of Myanmar today—South Korea grew more than twentyfold by 2014. Malaysia and Zambia began with near-identical per capita incomes, yet the average income in Malaysia today is more than seven times that in Zambia. Similarly, Indonesia and Rwanda began at similar levels of per capita income in 1960, yet Indonesia's average income today exceeds Rwanda's by a factor of four. Overall, East Asia as a whole has grown at twice the average annual rate as Latin America, and more than four times the average annual rate as Sub-Saharan Africa between 1960 and today (see Appendix Table A.1).

In addition to the overall growth across the region, there is also substantial within-region variation in economic performance. The East Asian NICs clearly stand out for maintaining impressively high growth rates throughout the period, though they are beginning to slow in the 2000s. Among the ASEAN-4 (the countries with the four largest economies among the Association of Southeast Asian Nations, comprised of Indonesia, Thailand, the Philippines, and Malaysia), Malaysia, Thailand, and Indonesia have maintained high growth rates throughout the period. The Philippines, however, has stagnated, growing by an average of only 1.67 percent annually between 1960 and 2014—less than half the average growth rate of Indonesia. It is worth noting that while Indonesia, Thailand, the Philippines, and Malaysia are often grouped together, they actually began with substantially different initial incomes. In 1960, Malaysia's initial income was more than three times that of Indonesia; thus, the roughly similar growth rates across Malaysia, Indonesia, and Thailand across the period have catapulted Malaysia to a substantially higher-income country today. The growth period in China, Vietnam, Cambodia, and Laos began later than it did in other countries in the region. Yet all have posted average annual growth rates above 5 percent—since the 1980s in China, the 1990s in Vietnam, and the 2000s in Cambodia and Laos. Some countries in the region, however, have been left behind altogether; Myanmar, Mongolia, North Korea, and Brunei posted low and volatile growth rates throughout the period.

Increasingly, economists discuss not only growth but also structural transformation as key to long-term increases in standards of living (for example, Breisinger and Diao 2008; Whitfield et al. 2015). Fundamentally, structural transformation is about shifting away from an economy based on primary products exploited by unskilled labor and toward an economy based on knowledge-based assets exploited by skilled labor (Amsden 2001). Several stylized facts tend to characterize the structural transformation process, including increases in the share of manufacturing in the economy (and parallel decreases in the

share of agriculture in the economy) and decreases in the share of the total labor force employed in agriculture. As labor moves away from less productive to more productive activities, the economy grows—even if there is no productivity growth within sectors. From a historical perspective, however, structural transformation has often been initiated by improvements in agricultural productivity. These improvements free up labor to move into modern sectors, a transition Pritchett (2004) terms the “essence of development.”

Although growth and structural transformation are intimately linked, they do not necessarily flow together. In the ideal version, increases in agricultural productivity free up labor to move from low-productivity agricultural activities to the higher-productivity manufacturing sector. However, manufacturing-led growth can also be spurred by foreign investment rather than by a more productive agricultural sector. Because this form of sectoral diversification is not predicated on increases in agricultural productivity, the rural population may not be absorbed into the modern sector. Further, an absence of linkages between foreign and domestic firms and between sectors results in a heavy reliance on imported inputs, resulting in what Wade (2005) calls a “technologyless industrialization.”

With this in mind, some scholars have argued that developmental states should be distinguished by their ability to “upgrade” rather than their economic growth or sectoral diversification alone (Doner 2009; Doner, Ritchie, and Slater 2005). Upgrading requires not just shifting from agricultural to manufacturing, but “moving into higher value-added products, at high levels of efficiency, with local inputs” (Doner 2009, 3). Upgrading, they argue, is necessary for sustainable development, as participation in global manufacturing processes at the lowest end of the value chain leads to declining income over time due to international competition. The low-wage advantages that initially attract foreign capital for manufacturing processes put countries “in a ‘nutcracker,’ squeezed between new low-wage competitors and those countries with higher wages but stronger technological and innovation capacities” (Doner 2009, 14).

In summary, we can think of three broad groupings of countries: those with high economic growth driven by both sectoral diversification and upgrading, those with high economic growth driven primarily by sectoral diversification with more limited upgrading, and those with limited growth. Distinguishing between these outcomes is a vital component of exploring the relationship between the state and development, as each may require different capacities and activities from the state.

Figure 4.1 sheds light on the extent of structural transformation across the region. It uses data from the Groningen Growth and Development Center, which provides employment and real value-added statistics for eight countries in East Asia—China, Indonesia, Japan, South Korea, Malaysia, the Philippines, Taiwan, and Thailand—disaggregated into 10 sectors (Timmer, de Vries, and de Vries 2015). Figure 4.1 shows changes in contributions to the economy, employment, and productivity of the manufacturing and agricultural sectors between 1965 and 2010.¹⁵ Two distinct patterns are clear across the figures. In one set of countries—South Korea, Taiwan, and Malaysia—economic growth has coincided with an increasing share of manufacturing in the economy, decreasing shares of agricultural employment (and increasing shares of manufacturing employment), as well as increases in both agricultural and manufacturing productivity levels. In contrast, sectoral diversification in the economy and in the labor market in Indonesia, Thailand, and China has coincided with only modest increases in agricultural productivity. Moreover, in Indonesia and Thailand, precipitous declines in the share of the labor force employed in agriculture haven’t necessarily coincided with corresponding increases in the share of the labor force employed in manufacturing.

¹⁵ I exclude the city-economies of Hong Kong and Singapore, as the agricultural sectors in these countries is insignificant. I convert local currency value added to 2005 prices using 2005 PPP (purchasing power parity) exchange rates (WDI 2015). Labor productivity was calculated by dividing each sector’s value added by the level of employment in the sector.

Figure 4.1 Structural transformation across East Asia

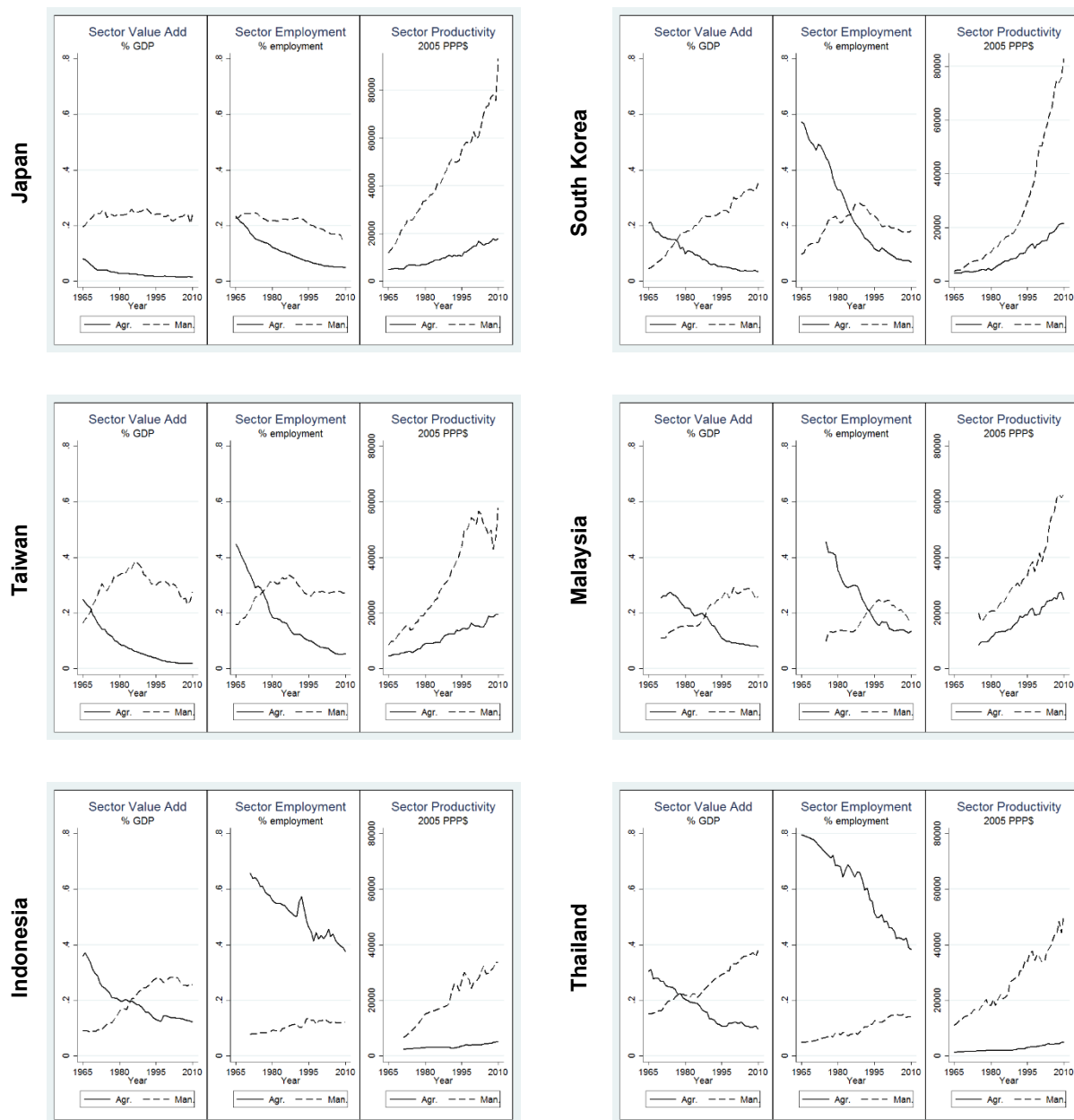
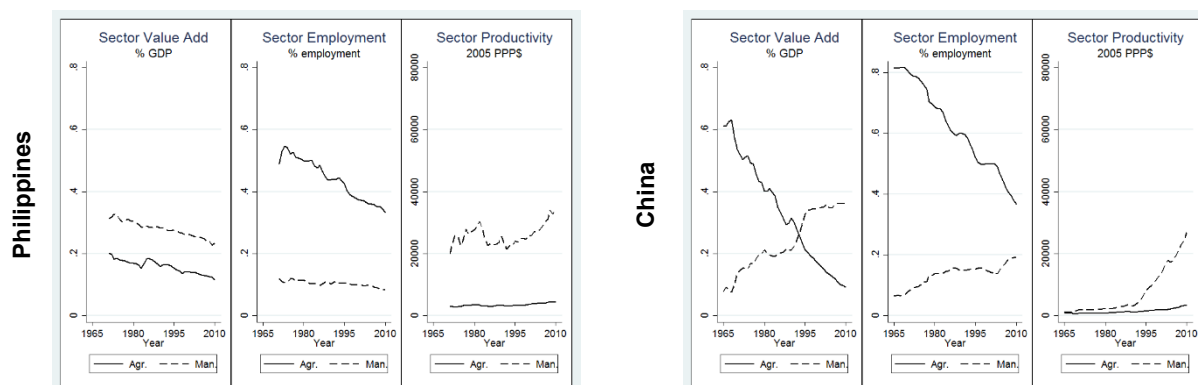


Figure 4.1 Continued



Source: Author's compilation using data from Timmer, de Vries, and de Vries (2015).

Note: I convert local currency value added to 2005 prices using 2005 PPP (purchasing power parity) exchange rates (WDI 2015). Labor productivity was calculated by dividing each sector's value added by the level of employment in the sector.

Examining upgrading—the extent to which economies are moving into the production of higher value-added products—across the region reveals similar patterns. East Asia, not surprisingly, has a far greater share of manufacturing exports (92.5 percent) than other regions. Its concentration in high-technology manufacturing is also notable compared with other regions (see Appendix Table A.2). However, there is considerable variation within the region with regard to the extent of upgrading into high-technology manufacturing. While the exports by the East Asian NICs clearly concentrate in high technology, Malaysia and the Philippines show high shares of high-technology exports as well. Indonesia, by contrast, has upgraded far less. Thailand stands in the middle, with a greater concentration in medium-technology exports. China and Vietnam, meanwhile, are rapidly expanding the share of high-technology exports, exhibiting evidence of upgrading (see Appendix Table A.2).

In summary, even among the high-performing economies of East Asia, there has been considerable variation in growth trajectories. Some economies have experienced high growth, sectoral diversification, and upgrading (Japan, South Korea, Taiwan, Hong Kong, Singapore, Malaysia,¹⁶ and, in later periods, China and Vietnam). Others exhibit high growth and sectoral diversification with limited productivity improvements and upgrading (Indonesia and Thailand, and, in later periods, Cambodia and Laos). Still others, to varying extents, have performed poorly on most dimensions (the Philippines, Myanmar, Mongolia, Brunei, and North Korea).

Equity and Capability Enhancement

Many development economists now recognize that growth and development more broadly are driven not just by capital accumulation or even sectoral diversification and upgrading, but by expanding human capabilities. Sen's (1999) capability approach to development notes that human capabilities are both the ultimate goal of development and the primary means of achieving it. This approach dovetails with empirical evidence indicating that human capital plays an important role in generating economic growth and in "endogenous growth theory," which argues that creating and utilizing new ideas is more important to growth than the accumulation of tangible capital.¹⁷

¹⁶ There are significant debates about whether Malaysia has achieved upgrading. On the one hand, Ritchie (2005), Doner (2009), and Doner, Ritchie, and Slater (2005) do not classify Malaysia as having technologically upgraded by 2005. On the other hand, Malaysia has entered into high-technology manufacturing to a greater extent than many other developing countries, including those in Southeast Asia.

¹⁷ See Romer (1994) for a discussion of endogenous growth theory.

In light of this, Evans (2010) revisited the idea of the developmental state, arguing that the concept should be updated for the 21st century given new ideas about development premised on enhancement of human capabilities. These include increasing education and cognition, rising life expectancy, and expanding political and civil rights (for instance, freedom of speech). Early writings on developmental states did not emphasize these factors, except to note when improvements in education and health care served to enhance economic growth, and certainly did not view political and civil rights as fundamental components of development. In fact, the authoritarian and semi-authoritarian characters of many developmental states were typically seen as assets that allowed the state to pursue coherent, stable, and centralized policies more easily.

Conceptualizing development as capability expansion changes the nature of the state capacity required for development. Implementing industrial policy is complex, but delivering high-quality education and health care services that actually improve knowledge and life expectancy may require even higher levels of state capacity. Evans (2010) argues that a deeper form of embeddedness is required to achieve these outcomes, specifically, a democratic form that enables policy deliberation and accountability/feedback loops. Similarly, including equity as a component of development requires a state motivated to and capable of redistributing wealth.

However, the East Asian development experience reveals that many of these good outcomes do not automatically go together and that there may be trade-offs among them. For example, authoritarian structures, which by definition limit civil and political liberties essential to the capability enhancement view of development, have been deployed across the region to implement widespread land reform. This was the basis of the high levels of economic equality achieved in many of the developmental states. Further, contrary to Evan's (2010) assertion that deep embeddedness is needed to foster social outcomes like health and education, the East Asian NICs achieved vast improvements in both while under autocratic rule.

Figure 4.2 (a-k) chronicles the historical patterns of growth and inequality across the region. It is clear from the figures that no singular pattern of growth and inequality prevails across East Asia, even within the NICs. Japan, South Korea, and Taiwan start off with relatively low levels of inequality, with Gini coefficients of 37, 34, and 32, respectively—reflecting the large-scale land reforms pursued by each country in the aftermath of the Second World War. However, their experiences differ over time. Japan experienced mostly declining inequality until the early 2000s, when inequality began to climb. South Korea experienced increasing inequality during the initial growth period in the 1960s and 1970s, followed by declining inequality until the early 2000s, when inequality began to rise again. In Taiwan, inequality has remained remarkably low and steady over time. In the city-state economies of Hong Kong and Singapore, by contrast, inequality started off substantially higher and has climbed steadily over time.

Figure 4.2 Growth and inequality across East Asia

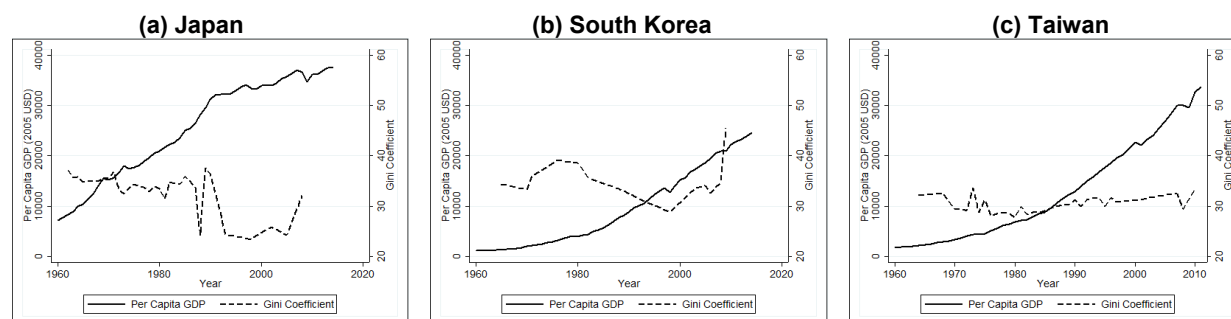
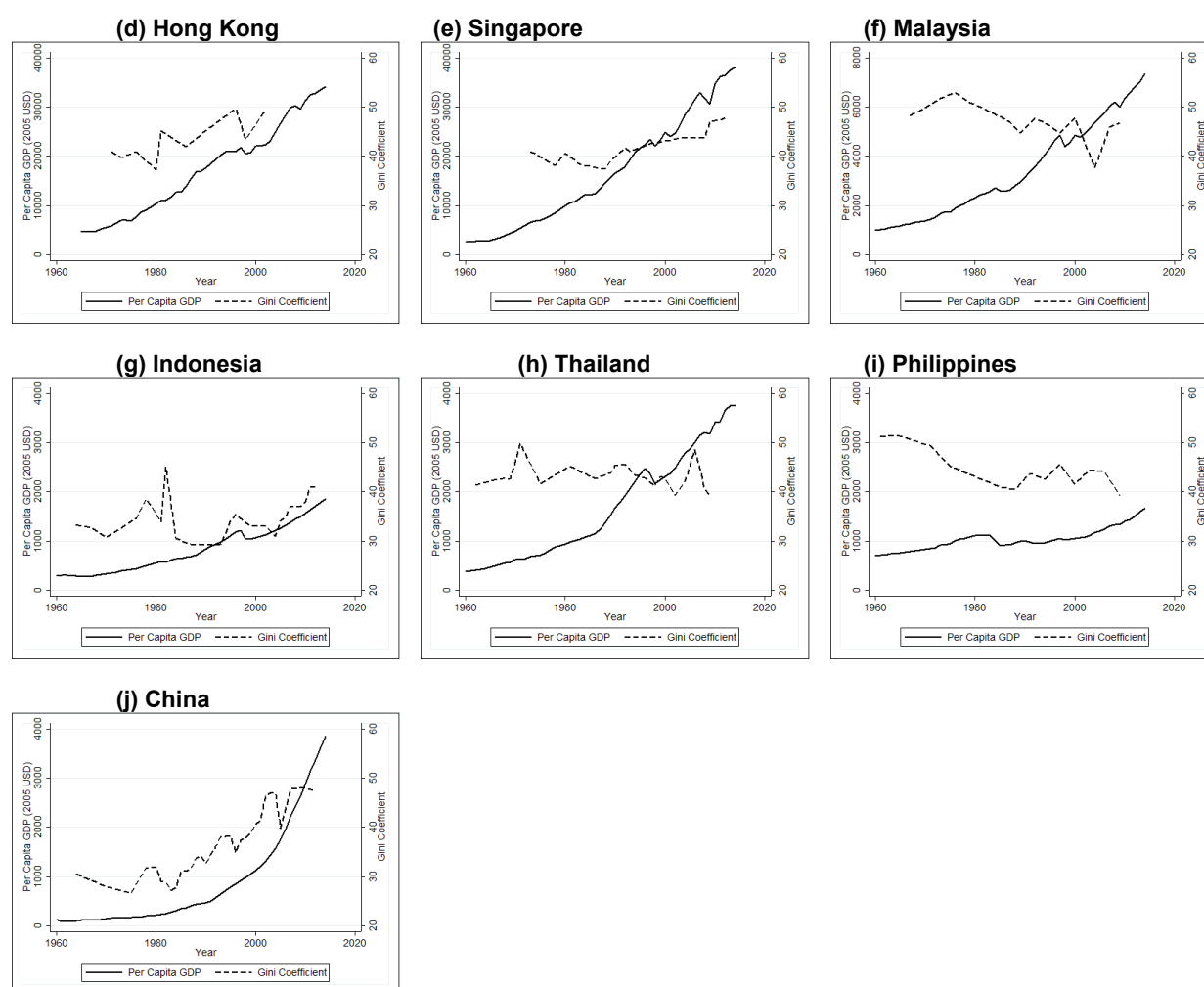


Figure 4.2 Continued



Source: World Development Indicators (2015); Milanovic (2013).

Note: There was not enough data available to graph inequality meaningfully over time in Cambodia, Laos, North Korea, Myanmar, Vietnam, Mongolia, Timor-Leste, or Brunei.

The Southeast Asian economies show similar amounts of variation in growth trajectories. Malaysia and the Philippines started off with the highest levels of inequality, with Gini coefficients of 48 and 51, respectively (Figures 4.2 [f and i]). Both countries have seen declines over time in inequality, though Malaysia's growth record exceeds that of the Philippines by more than four times. Thailand has grown rapidly, maintaining high and steady levels of inequality, while Indonesia has more recently seen greater volatility and increasing inequality (Figures 4.2 [g and h]). Meanwhile, China has clearly exhibited rapidly rising inequality concomitantly with rising income (Figure 4.2 [j]).

In summary, while many states across the region grew at unprecedented rates, not all experienced inclusive growth in the sense of rising per capita incomes going hand-in-hand with declining inequality. While Japan, South Korea, and Malaysia experienced declining inequality concurrently with rapidly rising incomes, China, Singapore, Hong Kong, and Vietnam saw the opposite trend. Taiwan, meanwhile, maintained low levels of inequality throughout. Thailand also maintained steady levels of inequality, though at a substantially higher level. The Philippines saw declining inequality but little growth.

In terms of social outcomes, the NICs have made impressive progress in educational attainment and life expectancy. In 1965, life expectancy in South Korea was only 57 years—lower than that in Thailand, which had a per capita income only one-third that of South Korea at the time. Yet, by 2014, life expectancy in South Korea was on par with Japan, despite having a per capita income nearly 40 percent lower. In this sense, South Korea’s achievements in human capability enhancement have exceeded even what would be expected with its high levels of economic growth.

Malaysia also stands out for making remarkable improvements in educational attainment between 1980 and 2014 (Appendix Table A.3). In 1980, an adult in Malaysia had attained an average of only four years of schooling; by 2014, it was 10 years, an increase of 150 percent that was on par with that of Singapore. Also standing out is the Philippines, which in 1980 boasted the highest mean years of schooling in all of Southeast Asia; by 2014, only Malaysia has exceeded it. Mongolia has far higher levels of educational attainment than would be expected based on income growth alone. China has also made dramatic improvements in human development over the period, including a 54 percent increase in life expectancy and a 92 percent increase in mean years of schooling.

However, many of these social outcomes have been achieved under conditions of low political and civil freedom, and even repression. South Korea, Taiwan, and Singapore began their developmental trajectories with “developmental dictators” Park Chung-hee, Chiang Kai-shek, and Lee Kuan Yew. Repression of civil society was severe: labor unionization and assembly were completely illegal during the Park regime. Park declared martial law, dissolved the National Assembly and all political parties, and censored the press. He also made heavy use of the Korean Central Intelligence Agency to monitor citizens’ activities (Kim 2010). Although South Korea began democratic transition in the late 1980s, its key developmental period was authoritarian and repressive. Democratic institutions are limited across the region. Beyond the East Asian NICs and Japan, only Thailand, Indonesia, the Philippines, and Mongolia have maintained a “free” rating from Freedom House for at least 5 of the past 42 years (Appendix Table A.3). Kohli warned “any assessment of economic success in [developmental states] must be weighed against the serious political costs paid by the citizens of these countries” (2004, 421).

Growth Pathways across East Asia

Based on the different ways of conceiving development outlined above—as an increase in per capita income, as transformation, as upgrading, and as capability enhancement—I identify five distinct growth pathways across East Asia. Table 4.1 summarizes the different growth pathways, their key characteristics, and the sets of countries affiliated with each. These are intended to provide broad categories to better understand development outcomes across the region and how they differ. In the following section, I discuss the specific developmental roles and structures states play in each development trajectory.

Table 4.1 Growth pathways across East Asia

Growth pathway	Description	Countries
Inclusive transformation	<ul style="list-style-type: none"> • High economic growth • Upgrading, including increasing agricultural productivity and expansion into high-technology exports • Accompanied by low or decreasing inequality • Often coincides with authoritarian regimes and repression in early stages 	Japan, South Korea, Taiwan, Malaysia
Unequal upgrading	<ul style="list-style-type: none"> • High economic growth • Upgrading, including increasing agricultural productivity and expansion into high-technology exports • Accompanied by high or increasing inequality • Often coincides with authoritarian regimes and repression in early stages 	China (1980s–present), Hong Kong, Singapore
Incomplete transformation	<ul style="list-style-type: none"> • High economic growth • Some sectoral diversification, but limited expansions in agricultural productivity and concentration in low- and medium-technology exports • Accompanied by high or increasing inequality 	Indonesia, Thailand, Cambodia (1990s), Laos (1990s–present)
Low growth capability enhancement	<ul style="list-style-type: none"> • Low economic growth • High or expanding human capabilities and reducing inequality • Often coincides with more open and democratic regimes 	Philippines, Mongolia
Poor performers	<ul style="list-style-type: none"> • Low economic growth • Limited sectoral diversification and limited upgrading • Limited expansion of human capabilities 	Myanmar, Brunei, North Korea, Timor-Leste, Cambodia (pre-1990s), Laos (pre-1990s), Vietnam (pre-1990s)

Source: Compiled by author.

Democracy and Development

Examining the growth pathways within the region, it is easy to conclude that authoritarianism is good for development. Indeed, many of the characteristics of developmental states emphasized by the literature, such as autonomy from social pressure, seem to be authoritarianism by another name. The comparison in growth performance between Asia's two largest countries—India and China—has stoked the idea that authoritarianism is better for development. Democracy skeptics abound, concerned that popular demands for short-term consumption and redistribution will crowd out long-term investments (for example, Haggard and Kaufman 1995; Huntington 1968) and that the need to win elections will encourage politicians to pursue unsustainable economic policies (for instance, Besley and Coate 1998). Taken to an extreme, this line of thinking has been used to support the “full belly thesis,” or the idea that the right to development precedes the right to democracy.

The idea that democracy promotes, rather than inhibits, development is equally prevalent, premised on the idea that a broader distribution of power in society leads to improvements in social and economic conditions. A primary contention of the institutional economics literature is that democratic checks and balances are needed to prevent the state from being confiscatory to ensure the protection of private property rights (for example, North and Weingast 1989). Security of citizens' property rights under democratic checks and balances, in turn, increases their incentive to produce more income (Olson 1993). Even if a democratic leader did encroach on private property, in theory a free press could discover and record the encroachment—reducing the leader's chances of retaining office—and an independent judiciary could overturn such an act. Democracies are further credited with being more likely to promote equitable development. Majoritarian demands, the argument goes, encourages redistribution; democratic politicians cater to the needs of the poor because they compete for their votes. From the perspective of development as capability enhancement, political and civil freedoms are both an end and a means: democracy can promote development but it is also an objective of development.

Many of the arguments in both directions are premised more on political institutions than on whether countries hold regular elections. Democracies, in name, may not have meaningful constitutional checks on executive power, a fully free press, an independent judiciary, or institutions that can effectively aggregate and advocate for the interests of the poor. Meanwhile, autocracies can have meaningful veto players and be motivated to pursue the interests of the poor. East Asia provides many examples of authoritarian and semiauthoritarian regimes pursuing redistribution on a large scale and implementing widespread and effective social programs (see Mares and Carnes 2009 for a review of the authoritarian origins of social policy in developing countries). In East Asia, the threat of rural, communist rebellions has provided at least as strong, if not stronger, a motivator for pursuing large-scale redistribution as elections. Further, even within semiauthoritarian settings, political parties can have meaningful grassroots engagement with citizens, as will be discussed in the Malaysian context. Of course, autocracies are frequently not focused on long-term investments, and leaders use the restricted political space to facilitate personalistic rule and rent-seeking. Throughout the review, I focus more on the institutions underpinning regimes than on regimes type per se.

5. DEVELOPMENTAL ROLES AND DEVELOPMENTAL STRUCTURES

Each of the developmental pathways that have been described—inclusive transformation, unequal upgrading, incomplete transformation, and low growth capability enhancement—requires different institutional roles and capacities from governments to succeed. Structural transformation necessitates overcoming risks to invest in new sectors, but reducing inequality requires overcoming resistance to redistribution. Upgrading entails learning to adapt to new technologies and overcoming collective action problems to develop local linkages. Different types and levels of development, in other words, require different tasks.

This section is structured around the concepts of developmental roles and developmental structures.¹⁸ Developmental roles are the tasks that the government performs to promote development; developmental structures are the institutions through which they perform those roles. A developmental state is one that employs developmental structures to play a developmental role. This leaves open the possibility that states could attempt to intervene in the market to promote late industrialization but fail because they lack the institutional design to formulate and implement industrial policies well; it also allows states with sufficient capacity to implement state-led development to choose not to do so.¹⁹

I develop this section in two parts. First, I discuss what states need to accomplish—the types of problems they need to solve—to implement different types of development policies. Here, I cover agricultural and social as well as industrial policy. Second, I discuss the institutional design, or developmental structures, that are required to implement developmental policies. I not only emphasize the institutional designs across states that have been identified as developmental, but link specific institutional designs with specific needs to accomplish policy tasks.

The recognition that economic development requires strong institutions has become a tenet in development literature. However, the focus has primarily been on fairly macro-level institutions, such as the protection of property rights and an independent judiciary. The strength of more meso-level institutions—for example, the coordinating institutions between government agencies and private sector actors or between different tiers of government—receive less attention. This is despite the fact that they often take on the responsibility of formulating and implementing policies. Moreover, not all development tasks are equally difficult, and different types of institutional capacities are necessary to implement different development strategies. Why, for example, was Thailand able to achieve sectoral diversification, but not economic upgrading into higher value-add products produced with local inputs? Why was Thailand not able to address its high levels of inequality, while Malaysia, at a similar starting point, made significant progress in reducing inequality?

Developmental Challenges

The key to these answers lies in understanding the particular types of challenges developing countries must confront to achieve different development outcomes. Market failures, often caused by collective action problems, are pervasive in developing economies. Such problems arise when individual rationality leads to an allocation of resources that leaves society worse off than would feasible alternatives. Institutions provide one solution to collective action dilemmas by making it in the private interests of individuals to make decisions consistent with social welfare. Doner (2009, chapter 3) argues that collective action problems in development policies can be differentiated by three factors, each requiring different institutional strengths and designs. Specifically, the difficulty of development policies will depend on the following characteristics:

¹⁸ A framework developed by Vu (2007).

¹⁹ Thus, defining developmental states in this way avoids the tendency to classify them based on successful economic performance, a concern expressed by Mkandawire (2001).

- The number of actors involved in policy implementation
 - How many actors must be involved to formulate a policy successfully?
 - Are a large number of transactions required to implement a policy or deliver a service?
- The complexity of the information required to formulate and implement the policy
 - How much technical knowledge is required to formulate and implement a policy?
 - Is there a clear solution, or do policy makers need to analyze and synthesize large amounts of information to develop one?
- The severity of the distributional consequences
 - Who stands to gain and lose from a given policy? How politically powerful are the potential losers?
 - How quickly are losses vs. gains experienced?

In general, the more actors involved in implementing a policy, the newer and/or more complex the information required to formulate and implement it, and the more severe the distributional consequences that the policy imposes, the more difficult the task is to accomplish. Each of the different developmental pathways outlined in Section 4 requires different institutional capacities because each raises different kinds of policy challenges.

Developmental Structures

I emphasize two underlying dimensions of developmental structures that enable states to take on developmental roles and solve development challenges: institutional and political capabilities. These could also be thought of as the organizational ability to implement a policy and the relational ability to do so, that is, the ability to compel actors to comply with a policy. States could be institutionally strong and politically weak, politically strong and institutionally weak, both, or neither. While institutional capacity is key to overcoming policy problems driven by the number of actors and the complexity of the information involved, political capacities tend to be central to overcoming policy problems driven by the distributional consequences of development policies. Still, neither dimension is sufficient to successfully implement developmental policies. Autonomy from social forces enables states to select developmental goals, but states still need the organization capacity to pursue the goals successfully. Similarly, states could possess a capable bureaucracy but use it in service of rent-seeking rather than development.

This discussion is not exhaustive, but focuses on the key aspects of developmental structures important to solving particular types of policy challenges. Although many of the characteristics of developmental structures are similar to those emphasized within the developmental state literature reviewed in Section 2, the difference is that I discuss the “fit” between capacities and challenges. This allows for the possibility that states with different institutional and political strengths can solve some developmental challenges and not others, allowing for the diversity of development trajectories observed in Section 4.

Institutional Capabilities

One of the primary lessons of the developmental state literature has been the crucial importance of state capacity for sectoral diversification and upgrading. In this context, state capacity is most usefully understood as the ability to formulate and implement coherent policy. I address four distinct elements of institutional capability: the capacity to consult, to implement, to monitor, and to problem solve.²⁰

²⁰ In his book on economic upgrading, Doner (2009) emphasizes the capacity to consult, credibly commit to policies, and monitor as the key dimensions of institutional capabilities necessary to achieve upgrading. I view the ability to credibly commit to enforcing policy as a reflection of the underlying political settlement in the country—of whether powerful actors have the

Consultation

The capability to consult involves the ability to bring a wide range of actors to the table to collect information and build trust. Effective consultation is important to both policy design and policy implementation. In designing a policy, consultation with private-sector actors can help government counterparts to develop practical expertise and industry knowledge, to the point where they can understand the real constraints facing particular industries and firms. Routinized consultation can also help to forge trust among actors and reduce uncertainty about the actions of others: through consultation, business and government can learn about each other's preferences and capabilities. It also enables business and government to coordinate investments. Regular interactions between business leaders and bureaucrats have been cited as key to developing effective industrial policy, particularly in Japan and South Korea.

Consultation is equally important for effective policy implementation. Often, development practitioners tend to think of particular government agencies as responsible for particular policy areas (for example, a trade ministry in charge of trade policy). In fact, policies affect a wide range of private-sector actors and government ministries, and their cooperation is necessary to ensure policy success. For example, a government seeking to boost manufactured exports needs to consult with and coordinate across ministries of trade to ensure that trade policies allow the import of any necessary inputs and the efficient export of the targeted goods. Governments must also consult with and coordinate across ministries of commerce to potentially target subsidies and tax policies, ministries of education to coordinate worker training and skills development initiatives, and ministries of infrastructure to coordinate public investments in electricity and roads, among others. This consultation process serves not just to coordinate actions but can also be an important way of legitimizing policies, increasing the willingness of those responsible for following through on policy implementation. The ability to consult becomes increasingly important the more complex the informational content of the policy area and the greater the number of actors involved in implementation.

Implementation

Typically, implementing a policy requires multiple actions by multiple actors. Consultation and communication is key to coordinating actions, but coordination is rarely the only barrier to successfully overcome collective action problems. Actors who perform government functions need to be capable and motivated to do so—qualities frequently referred to as the “personnel economics” of the state.²¹ Governments will struggle to improve the quality of education, for example, if teachers are frequently absent from classrooms or lack the skills to teach effectively.

The literature highlights several characteristics of government personnel in developmental states that have been linked to successful implementation of development policies. Developmental states have been linked with meritocratically recruited and professionalized bureaucracies. Meritocratic recruitment can be a means of both ensuring that the bureaucracy is staffed with individuals with the skills to do their jobs and of elevating public service as a profession. Professionalization within the bureaucracy, including the development of coherent career ladders, can enable bureaucrats to acquire expertise during their tenure.

However, the extent to which different elements of the bureaucracy need to be meritocratic, professionalized, and highly capable depends on the policy challenge being confronted. For example, implementing industrial policy may require only “pockets of efficiency” within the bureaucracy that are enclaved and protected from political pressures (Whitfield et al. 2015). On the other hand, implementing an education initiative requires both the participation of central line ministries, local line ministries, and frontline service providers. The greater the number of actors required to implement a policy, the more

power to resist government policy enforcement. Thus, I discuss the ability to credibly commit as a component of the government's political capabilities.

²¹ See Finan, Olken, and Pande (forthcoming) for a recent review on the personnel economics of the state.

important broad capacity within the government becomes. Policy tasks with higher informational complexity may also require greater capacity of government officials.

Monitoring

The ability to monitor—to obtain information about the actual behavior of other actors—is also critical to ensuring that actors follow through with policy implementation. Monitoring capabilities are particularly relevant when the actors responsible for policy implementation are local. The actions of local bureaucracies, particularly in remote, rural areas, are difficult for central governments to observe without strong periphery-to-center communication ties. Monitoring capabilities are also important when policies involve rewards and sanctions. States cannot enforce performance standards without the ability to monitor performance.

Problem Solving

However, too much focus on monitoring policy implementation can obscure larger questions about whether the policy itself is achieving the desired outcomes. Governments need mechanisms to learn from policy implementation and whether it is successful from the perspective of achieving the desired development outcomes. The ability to learn is composed of at least two components: the willingness to experiment, and a means of feeding back information about what worked (and what didn't) into the policy system. Ostrom emphasizes the difficulty of finding the combination of rules that work in a particular context and, thus, argues that it is necessary to “try multiple combinations of rules and keep making adjustments to get the systems working well” (2008, 49). Creating an environment where policy implementers are “authorized” to experiment with what works is also highlighted in the Problem-Driven Iterative Adaptation approach to policy reform (Andrews 2013; Andrews, Pritchett, and Woolcock 2012).

Although it is not formally part of the developmental state literature, the ability to experiment and adapt policies to suit local contexts is mentioned in many descriptions of developmental states. Regarding Japan, Morishima states that “there was never an accurate blueprint for the Meiji Revolution; the revolutionaries learnt what the issues and solutions were by repeating the process of trial and error” (1984, 71). Ranis (1991) offers a similar characterization of the policy-making process in Taiwan. The ability to problem solve and experiment is particularly important when a development task is especially complex or applies to a sector or policy area with which the government has relatively little prior experience.

Political Capabilities

Even if a state is organizationally capable of pursuing a development agenda, it needs “the ability ... to persuade key players to adhere to its development agenda” (Mkandawire 2010, 72). This could be thought of as the relational power of the state, that is, the power of the state in relation to different social groups that could resist government policy making. The developmental state literature raises this point as the autonomy of the bureaucracy, or the ability of politicians to insulate the bureaucracy from powerful social groups vying for influence and attempting to resist policy enforcement. Politicians can only do so when they have power vis-à-vis social groups. The relative power of different social groups shapes the relative costs of different policies for ruling elites, as powerful social groups can remove politicians from office. Thus, the distribution of power between state and society shapes the state's capacity to pursue and implement different development policies. A state cannot be strong without both organizational and relational power (Migdal 1988).

Three key aspects of the relational power of the state are key in shaping the state's ability to push through development policies, especially those that have redistributive consequences. First, the “relative autonomy” of the state can refer to the socioeconomic elite within the country. Two types of socioeconomic elite are relevant: the class of rural, land-owning elite and the class of domestic capitalists. The power of these groups can derive from their relative importance in the economy, their importance as a source of government revenue and foreign exchange, and, relatedly, their importance as a source of

political financing for the ruling elite. A strong rural, land-owning elite could block state efforts at supporting urban industrialization if it fears being replaced in a new industrial political order (Acemoglu and Robinson 2006). By contrast, a strong class of domestic capitalists could motivate the government to support industrialization. The delicate balance in the relative power of capitalists and the state can be conducive to state-led industrialization. Domestic capitalists need to be powerful enough to shape industrial policy in ways that can benefit early industrialization, but not so strong that they can evade policy enforcement, reducing government's ability to credibly commit to enforce policies (Whitfield et al. 2015). Elite groups with large amounts of political influence play a particularly important role in blocking development policies with large redistributive components.

Second, the extent to which the state is autonomous from the masses is relevant to its ability to resolve particular developmental challenges. The state's engagement with the masses can range from mass incorporation (bringing them into the political system) to mass suppression (using the state's coercive apparatus to exclude them from the political system). Some states may not have much of a choice between these extremes if they lack a coercive apparatus, such as a strong army or police force. In these cases, states may have to pursue mass incorporation, which will affect their ability to pursue particular developmental policies (Vu 2007). For example, suppression of the masses, including the urban working class and rural peasants, has been key to South Korea's pursuit of early industrialization. The state used force to extract agricultural surplus, which became a source of financing to support early industrialization. The degree of mass incorporation vs. suppression shapes the extent of mass resistance to economic policies with redistributive content.

Finally, the centralization of the state, or the extent to which the central government has power over the periphery, is key to its political capabilities (Acemoglu and Robinson 2012). A state with strong subnational sources of power will struggle to implement a coherent national policy agenda. This is particularly important for developmental policies with local implementation and jurisdictional spillovers; that is, those that are implemented by local bureaucrats and politicians but that require cooperation across local jurisdictions to be effective, such as large-scale infrastructure projects. The centralization of the state is also important for development policies that require a large amount of local knowledge, for example, the local enforcement of property rights.

Summary: Developmental Structures to Take On Development Roles

In summary, states can be strong and weak in many different ways; the key is the degree to which the different constellations of strengths and weaknesses enables states to take on different developmental roles. Table 5.1 provides a summary of the different institutional and political capabilities that form the developmental structure of the state, as well as the particular types of policy challenges that each dimension can help to resolve.

Table 5.1 Overview of developmental structures

Components of developmental structures	Dimensions	Important for developmental roles characterized by:
Institutional capabilities	<ul style="list-style-type: none"> • Consultation • Implementation • Monitoring • Problem solving 	<ul style="list-style-type: none"> • Large numbers of actors and transactions • High informational complexity
Political capabilities	<ul style="list-style-type: none"> • State-elite relations • State-mass relations • State-periphery relations 	<ul style="list-style-type: none"> • Significant redistribution • High amount of local knowledge

Source: Compiled by author.

Developmental Roles

If different developmental trajectories involve confronting different types of challenges, and different challenges require different developmental structures, then it is important to classify developmental policies according to the types of challenges they raise. On the ‘incomplete transformation’ growth pathway, countries have begun the process of diversifying the economy—in some cases, by a dramatic degree. Structural transformation requires investing capital in new economic activities and sectors. Overcoming the significant risk and uncertainty entailed in this process requires resolving and overcoming collective action problems: owners of capital need to coordinate investments, bureaucrats need to develop trade policies that can support the import of important technologies for new sectors and the export of new products, and workers need to acquire the skills and knowledge necessary to participate in new economic activities in new sectors. If significant rural-to-urban migration is required to staff new industries, the government may need to ease constraints on domestic migration. The government may also need to supply capital for public investments, for example, roads and electricity, to support new economic activities. If investments in new sectors are supplied primarily by foreign capital, firms in the new sector may not need to innovate or even learn new technologies. They may instead wait for new technologies to be brought in from abroad.

To achieve the “inclusive transformation” or the “unequal upgrading” growth pathway, countries must go beyond structural transformation, producing higher value-add products with local inputs and linkages. Although both outcomes require overcoming collective action dilemmas, the challenges involved in upgrading are more onerous. Further, countries that have achieved “inclusive transformation” and “low growth capability enhancement” have, to some degree, tackled redistributive challenges, reducing inequalities and raising standards of living across the board. I will discuss a number of different policy tasks; the extent to which they are required for structural transformation, upgrading, and capability enhancement; the particular types of challenges raised by each task; and the institutional capacities necessary to overcome these challenges.²²

Agricultural Policy

A declining share of employment in the agricultural sector is a key feature of structural transformation. It can be driven by the push of labor out of agriculture driven by improvements in agricultural productivity, or the pull of labor into the industrial sector driven by improvements in industrial technology. In the “push” scenario, improvements in agricultural productivity solve the food problem, allowing the agricultural sector to produce sufficient food with less labor to feed a growing population of urban workers. In the “pull” scenario, rising urban wages attract labor from the agricultural sector.

Governments intervene in agricultural markets in virtually every country in the world, whether it is through distributing land, protecting property rights, subsidizing agricultural inputs, taxing agricultural outputs, imposing (or removing) tariffs and quotas, setting food prices, supporting agricultural research, providing extension services, offering credit to farmers, or building rural infrastructure. Each of these policy initiatives can affect—either positively or negatively—agricultural productivity, the “push” side of structural transformation. The rationale for this intervention is often that farmers, especially smallholder farmers common in early stages of development, are affected by market failures. Among these are “the excludability of many agricultural technologies, coordination challenges that prevent exploiting economies of scale, information asymmetries, a lack of assets that can serve as collateral, and the vulnerability of smallholders to the biological, climatic, and market risks inherent in agricultural production” (Birner and Resnick 2010, 1442).

²² Much of the discussion in this section on structural transformation and upgrading is based on Doner (2009, chap. 3). However, Doner (2009) only examines economic upgrading as an indicator of development, and does not consider capability enhancement or inequality as a development outcome—indicators that I will address. He also does not incorporate agricultural and social policy into the discussion of development tasks that the government confronts to achieve upgrading.

Rather than discuss in detail every potential agricultural policy option, I focus on four broad categories of policy. Each has different characteristics in terms of the specific challenges they pose to state capacity. In some, the challenge relates to informational complexity (for instance, agricultural research), others require the participation of a large number of actors (for example, extension), and still others must deal with large redistributive effects (for example, land reform). Specifically, I focus on the broad areas of property rights, agricultural research and extension, agricultural subsidies, and rural infrastructure. I discuss trade policy under the heading of industrial policy, though clearly trade policy can target the agricultural sector as well. Discussion of the policy areas is meant to illustrate how different policy tasks can have quite different types of policy challenges. It examines implications for the types of capabilities needed to resolve the challenges, rather than providing a comprehensive overview of all types of policies in the sector. Further, the effect of the policy itself on economic outcomes is a separate question. Here, I focus on the ability of states with different institutional and political capabilities to successfully implement policies that pose different types of challenges. Whether and when these policies achieve the desired development goals is likely related to states' ability to implement them successfully, but this is a separate empirical question.

Property Rights

In economics, conventional wisdom dictates that property rights encourage the efficient use of land; investors must believe they will be able to reap the benefits of their investments. Investors' beliefs about whether they will be able to appropriate the economic benefits of productive activities are based on the security of property rights. Two distinct policy tasks are involved in establishing property rights regimes: establishing the allocation of land and establishing rights over that allocation, acts that may not necessarily coincide. Governments may enact large-scale land reforms without ever giving intended beneficiaries title to the land; other reforms could involve granting titles over existing land allocation without ever overhauling land distribution (Albertus 2016).

Enacting large-scale land reforms has been a cornerstone of the growth pathways in Japan, South Korea, and Taiwan. Other states in the region, including China and Vietnam, have enacted large-scale land reforms. A key difference between Japan, South Korea, and Taiwan on the one hand and Vietnam and China on the other is that the former enacted both large-scale land reform as well as protection of private property. Vietnam and China, in contrast, redistributed land but did so under collective ownership. States in Southeast Asia, such as Malaysia and Thailand, pursued a different course, focusing on opening up new lands to agriculture and granting titles over the new land rather than redistributing existing landholdings.

The number of actors involved in a property rights regime depends on several factors, including the number of different government agencies with responsibility over land policy and the number of potential landowners affected by a change in the allocation of property rights. Government agencies responsible for land reform could be responsible for interacting with each beneficiary multiple times—to process land claims, inspect properties, and distribute the plots—resulting in a large number of actors and transactions to manage. In Taiwan, for example, land reform involved government-sponsored tenancy committees that resolved more than 62,000 landlord-tenant disputes between 1952 and 1956 (Nordhaug 1997, as cited in Doner 2009, chapter 3). In terms of informational complexity, establishing titles over land can require extensive local knowledge, though not complex technical knowledge. By far the most difficult challenge raised by land reform is distributional: enacting land reform requires the ability to overcome opposition from the powerful landowning elite.

Agricultural Extension / Research

Agricultural research and extension services can also be an important tool by which governments can help to raise productivity. Market failures in this research are pervasive. Primarily, those who invest in agricultural research may struggle to capture all the benefits gleaned from the research, while others can free-ride on their investments. Therefore, private investments for which the private costs exceed the private benefits—but for which the social benefits may be much larger than the costs—may never be

undertaken by private actors.²³ The state can therefore be an important source of financing for agricultural research and development. Research does not require a particularly large number of actors, nor is it redistributive; this means there is likely to be little elite or mass resistance to government spending on research. Yet, for the same reasons, it may be difficult for the government to build a strong coalition in support of spending on agricultural research. However, informational complexity in agricultural research can be high; even internationally adopted technologies need to be adapted to local conditions.

While agricultural research may not require a large number of actors, the dissemination of research to farmers involves a large number of actors and transactions. Often, this dissemination is done through public-sector extension workers, who may need to interact with individual farmers on several occasions to effectively transmit information and affect farming practices. The large number of actors and transactions required, and the burden of incorporating highly localized information into the content of extension, can make providing effective extension services difficult.

Agricultural Subsidies

States have also pursued agricultural intensification by providing credit and subsidies to farmers. The extension of credit can reduce the risks faced by smallholders, while input subsidies can lower costs and encourage the adoption of high-productivity inputs like fertilizers and high-yield varieties. Of course, subsidies can also greatly distort agricultural markets and can become quite expensive for governments over time.

These policies are challenging because of the many actors required to deliver physical subsidies to farmers, particularly those in far-flung areas. The high value of subsidies makes the programs particularly vulnerable to rent-seeking and poor management. Moreover, the local actors who deliver them are often physically remote from the central government and therefore difficult to monitor. Further, subsidies have large distributive consequences, requiring significant political capabilities to implement (or remove) them. Informational complexity, by contrast, is relatively low.

Rural Infrastructure

Building rural infrastructure, such as roads and large-scale irrigation, is key to raising agricultural productivity and economic growth. Calderón and Servén (2003) attribute one-third of the difference between East Asian and Latin American output to East Asia's superior provision of infrastructure. Providing infrastructure is not terribly complex from an informational perspective, nor does it necessarily require a large number of actors or have a large distributional impact in the near term. However, it does require the political will to support large government investments in rural areas, as well as a degree of central control over the periphery. Because large-scale infrastructure projects span the jurisdictions of local governments, the central government needs to be able to induce coordination and cooperation among local governments.

Industrial Policy

In addition to declining shares of the labor force employed in low-productivity agriculture, structural transformation is marked by increasing shares of the labor force employed in the industrial sector. Just as targeted government initiatives can raise agricultural productivity through security of property rights, investments in agricultural research, and investments in rural infrastructure, industrial policy can “encourage investment in economic activities that are new to firms and farms by underwriting risk and by financing losses incurred while firms and farms become competitive” (Whitfield et al. 2015, 5). The role of industrial policy in economic upgrading is even greater than in sectoral diversification alone, as the collective action problems are more severe (Doner 2009).

²³ For a discussion of the various market failures involved in agricultural research and development, see Alston, Pardey, and Roseboom (1998).

Coordination and collective action problems can plague the move from agriculture to industry. Small market size and lack of complementary suppliers and consumers can deter early investments in the industrial sector. Current prices may not adequately capture information about future growth potential within the industry, causing holders of capital to forego investments that could improve industrial productivity. Upgrading, more than sectoral diversification, also requires innovation of the kind that can be absorbed and put to good use by local producers. This can require a great deal of information sharing among government agencies and between upstream and downstream firms. Upgrading also imposes efficiency pressures on the provision of local inputs, which can lead to distributive conflict, as underperforming firms can lose access to subsidies and incentives (see Doner 2009, chapter 3, for a full discussion of the challenges of upgrading).

Under the heading of industrial policy, I consider the policy areas relevant to encouraging capital holders to invest in new sectors and ventures, including macroeconomic and trade policies. As with agricultural policy, I focus not on the content or the effectiveness of particular types of policies, but rather on the types of challenges that the policy task raises and the capabilities necessary to overcome the challenges.²⁴

Macroeconomic Stability

Macroeconomic stability, through interest and exchange rate policy, is important.²⁵ Of course, providing macroeconomic stability is no easy feat. However, the difficulties are mostly political rather than institutional. Ensuring such stability requires relatively few actors: According to Pritchett and Woolcock, “ten smart people can handle the actual decisions and mechanics” of macroeconomic policy (2004, 194). Further, macroeconomic policy is not particularly complex from an informational perspective, since many guidelines exist on how to manage it. It is an especially potent tool for promoting industrialization: An undervalued exchange rate can effectively substitute for industrial policy, which is more difficult to execute well given the higher number of actors involved and the greater informational complexity, and may be one of the most effective tools for promoting industrialization (Rodrik 2008).

However, the real difficulty for macroeconomic policy is distributional. In the short term, shifts in macroeconomic policies involve clear economic winners and losers. Therefore, politicians require a high degree of political capability to pursue macroeconomic stabilization and to resist pressures of policy reversal. In other words, politicians need power vis-à-vis social actors to insulate economic policy making from social pressures.

Investment Promotion

For the industrial sector to get off the ground, capital holders must be willing to make risky investments. They face uncertainty about whether new economic activities will generate profits and who will benefit the most from the new sector or activity. Further, it isn’t enough if just one firm or actor makes an investment in a new economic activity. The scale of investment required to get a new industry or activity off the ground in a country often exceeds the capacity of any single firm. Governments can step in to encourage and coordinate these investments in several ways, including through providing tax incentives, subsidies and cheap access to credit, and, in some cases, by offering capital themselves.

The government can also look to foreign direct investment (FDI) as a source of capital and of technological knowledge. Governments can engage in a range of activities to promote FDI. On the one hand, they can promote structural change by offering tax holidays and incentives to foreign firms to make investments that can generate jobs and foreign exchange. On the other hand, for these investments to result in upgrading into higher value-add products produced with local inputs, governments may need to take a more activist role. This can be done by coordinating foreign firms and local suppliers, encouraging

²⁴ Much of the discussion of the policy tasks required for upgrading is based on Doner (2009, chapter 3).

²⁵ There is debate about the extent to which good macroeconomic fundamentals played a role in East Asian development. While inflation was kept below 20 percent in all high-growth economies, in some countries inflation rose above 10 percent. Countries did not always keep macroeconomic balance, either: Malaysia and Thailand had current account deficits in the 1990s (Jomo 2003b).

investment not just in a single industry but in a “cluster” of activities, and by supporting foreign investments through complementary public investments in worker training and infrastructure (Doner 2009, chapter 3).

The particular policy challenges posed by investment promotion really depend on the aims of the government and the extent to which the government actively pursues upgrading and local linkages. On the one hand, encouraging investment in a targeted economic activity may require interactions between a single government agency and a small number of firms, making collective action problems less daunting. Since the investment incentives target new economic activities, the distributional challenges are also not overly severe. However, the informational complexity and the number of actors rise significantly if governments pursue upgrading. In these cases, government may need to coordinate between upstream and downstream firms, or between foreign and local ones. For production processes to rely on local inputs, government actors need to understand global production processes, as well as “the widely varying technological properties of specific industries, the logistical and strategic concerns of multinational businesses, and the rapidly evolving international investment environment” (Doner 2009, 83). Thus, the need for the institutional capacity to consult widely and have at least a “pocket of efficiency” within a trade or commerce ministry expands dramatically.

While the redistributive implications of promoting investments in new sectors are not large, governments still need political capabilities to pursue investment promotion policies without being “captured” by business interests. Key to many of the successful incentives is the ability to offer rewards and sanctions conditional on performance. Thus, governments must have the capacity to withdraw incentives over time from firms that don’t meet performance standards. Withdrawing tax incentives and subsidies from unsuccessful firms was important to South Korea’s success in promoting exports: infant firms were protected, but protection was conditional on export promotion. Incentives were withdrawn if firms did not begin to export and become internationally competitive within a fixed time period, resulting in a dual policy of support and discipline (Amsden 1989). However, the ability to actually withdraw incentives and subsidies to infant industries once they are in place requires significant political capabilities. These include the ability of the government to resist pressures by firms to retain the incentives and to insulate policy making from these pressures.

Trade Liberalization

When promoting risky investment in new sectors, particularly those by domestic firms, governments often provide new producers with trade protections, so-called “infant industry protection.” The logic behind this is to provide these protections until the new industries can reach the economies of scale necessary to compete in the global marketplace. Setting these protections means that the government will eventually need to liberalize trade. As with investment promotion, the policy challenges posed by trade liberalization can vary. On the one hand, trade liberalization can be pursued as a blunt instrument. The distributional challenges of pursuing a broad trade liberalization agenda can be severe, as liberalization, particularly in the short term, creates clear winners and losers. While the government needs political capabilities to do so without risk of policy reversal, the informational and coordinating challenges are relatively low. On the other hand, to achieve upgrading, a more nuanced approach to liberalization may be required, as it can be challenging to allow competition while promoting local linkages. For example, governments may need to gather information from firms about how production processes work, and then design gradual liberalization agendas to protect local linkages.

Local Supplier Development

Doner (2009) also notes that upgrading requires the expansion of local suppliers. This is more than just matching suppliers to producers; in fact, government-sponsored matching programs between business and local suppliers rarely lead to sustainable partnerships (Schmitz 2005). Instead, buyers need to provide information on the specifications and technical requirements of the required inputs, and local suppliers need to develop the capacity to meet those requirements over time. This can mean sustained engagement among buyers, local suppliers, and government agencies to facilitate the coordination of these

engagements. Sustained engagement may also be needed to fill gaps with complementary public investments (for example, in the worker training required to meet technology standards). The challenge of this type of activity is primarily informational.

Social Policy

Finally, achieving “inclusive transformation”—including both reductions in inequality and upgrading—requires social policy. Social policy is not something to be done after development has been achieved, but is a “constitutive instrument and an end of the development process” (Mkandawire 2010, 71). That things like educational attainment and improvements in health are the end goals of development is a fundamental part of the development as human capability enhancement argument. At the same time, education and health are also important inputs into the development process. Indeed, the East Asian NICs invested heavily in health and education early in the development trajectory. Here, I focus on the particular policy challenges raised by implementing higher education policy. This is often considered essential to upgrading, though one could imagine covering a wider range of social protection programs.

Higher Education

The supply of workers with sufficient skills and education is a necessary component of upgrading into the production of higher technology, higher value-add products. Skills shortages, especially in numeracy and technical skills, make moving into medium- and high-technology sectors difficult. Investments in secondary and tertiary education can be particularly crucial, but the provision of high-quality education presents significant difficulties. Unlike other policy areas, such as macroeconomic policy, there is not a widely accepted template for how best to implement a higher-education system that improves learning in skills important for technology adoption. Thus, there is a need to create methods and use iterative problem solving to reach desired outcomes. This requires close monitoring of both implementation and outcomes.

Implementing education policy also calls for the participation of several government ministries and central as well as local government, including teachers. The central government’s ability to influence and monitor subnational policy implementation will be crucial. Educational policy can also be redistributive and thus a target of elite resistance. In Malaysia, for example, one significant change to the secondary education system was to reform the inherited and highly unequal colonial education system that taught secondary school only in English and catered to ethnic Chinese families belonging to the economic elite. Instead, the country adopted Malay as the language of instruction, opening up secondary school instruction to the masses. Thus, higher education policy, while critical for upgrading and for equity, presents informational and problem solving as well as distributional challenges. It also requires the participation of a large number of actors, including frontline service providers and local governments. This increases the importance of the overall capacity of the state to implement policy, as well as the influence of the state over the periphery.

Summary: Developmental Challenges, Developmental Structures, and Developmental Roles

The purpose of this discussion has been to illustrate that not all development policies are created equal. Each raises a different profile of policy challenges that requires different institutional and political capabilities to overcome. While the points covered do not comprise an exhaustive list of development policies by any means, the discussion provides an overview of many of the development policies that are crucial to achieving structural transformation, upgrading, and capability enhancement. Table 5.2 provides an overview of many of the development tasks for the inclusive transformation pathway, the specific policy challenges they present, and the types of institutional and political capabilities that are important to overcoming the challenges.

Table 5.2 Development tasks for inclusive transformation

Development task	Challenges			Capabilities required	
	Number of actors	Information Complexity	Distributional impact	Institutional capabilities	Political capabilities
Land reform	Varies	Medium	High	Low	High
Property rights	Varies	Low	Low	Medium	Low
Agricultural extension / research	High	Medium	Low	High	Low
Agricultural input subsidies	Varies	Low	High	Medium	High
Rural infrastructure	High	Low	Low	High	Medium
Macroeconomic stability	Low	Medium	High	Low	High
Investment promotion	Medium	Medium	Low	Medium	High
Trade liberalization	Medium	Medium	High	Medium	High
Supplier development	High	High	Low	High	Low
Higher education	High	Medium	Medium	High	Medium

Source: Compiled by author, adapted from Doner (2009, 78).

Note: Based on author's judgment.

6. MALAYSIA: INCLUSIVE TRANSFORMATION

Within Southeast Asia, Malaysia stands out for its high levels of economic growth and structural transformation and reduced inequality. With the exception of Singapore, it holds the highest per capita income in Southeast Asia (\$9,766 in current dollars). The economy has transformed to a remarkable degree: by 2010, less than 15 percent of the workforce was employed in agriculture, which comprised about 8 percent of the GDP.²⁶ Meanwhile, 84 percent of exports are manufactured goods, of which over 40 percent consist of high-technology goods (see Appendix Table A.2). These gains have translated into increases in standards of living and reductions in inequality: Poverty fell from 49 percent in 1970 to 3.8 percent in 2009, and the Gini coefficient fell from 0.53 in 1976 to 0.44 in 2009 (Kuhonta 2011).

It is also important to note that Malaysia's development is an ongoing struggle, and that while its development trajectory shares similar characteristics to those of South Korea and Taiwan, its transformation is more uneven. I classify Malaysia as a case of "inclusive transformation" due to the significant progress it has made in structural transformation and in reducing inequalities. However, unlike South Korea and Taiwan, Malaysia has not fully upgraded its economy. Malaysia's difficulty in upgrading operations in the hard-disk-drive industry in the 2000s and the subsequent loss of jobs to China and the semiconductor industry (which remains in the downstream stage of production, for example, packaging and assembling) are often cited as evidence (Doner 2009; Ritchie 2005).

Despite these difficulties, it is also clear that some regions in Malaysia, such as Penang, have successfully participated in high-technology manufacturing (Hutchinson 2008). Further, it is clear that Malaysia has been more successful than most other countries in the region, the East Asian NICs excepted, in entering high-technology industries even though they still struggle to innovate and capture technology spillovers. Malaysia has also shown an ability to upgrade within its traditional commodity-based sectors—oil and gas, rubber, and palm oil—utilizing higher levels of technology with greater employment of local services. Therefore, while the transformation may not be complete and formidable hurdles may remain, it is still worthwhile to examine Malaysia as a relatively successful case.

These achievements have not come easily and have occurred despite difficult starting points. From colonialism, Malaysia inherited high inequalities, driven by the British "divide and rule" strategy employed between the ethnic Malay and Chinese populations. The former were confined to traditional economic sectors; the latter were allowed to participate in more modern sectors. The result was a highly unequal society divided along ethnic lines. Upon independence, British officials expected that the country would be mired in ethnic conflict (Horowitz 1989). Indeed, Malaysia experienced intense and devastating ethnic riots in 1969, events that would prove decisive in its state-building and development trajectory. However, Malaysia was able to forge a ruling alliance, which held the country together, as well as relatively strong developmental structures.

Postcolonial Development, 1957–1970

Policy Content and Implementation

Malaysia did not begin its development trajectory with strong institutions. From the colonial period, they inherited a divided society where an ethnic Chinese minority dominated modern sectors of the economy—trade, rubber, and tin—and the ethnic Malay peasantry was confined to traditional, smallholder agriculture. However, ethnic Malay aristocracy (the traditional landed elite), were absorbed into the bureaucratic structure of the colonial state through a policy of indirect rule. In fact, only landed aristocracy were allowed into the Malaysian civil service during colonial rule. This policy ensured that "the postcolonial elite would largely be drawn from the landed and aristocratic classes and dominated by the Malay ethnic group" (Kuhonta 2011, 56).

²⁶ Authors' calculations using data from Timmer, de Vries, and de Vries (2015). Agriculture as a percent of GDP is calculated on a PPP basis.

By the 1940s, the British began to fear the political consequences of such a divided society, especially the growing economic and demographic power of the ethnic Chinese and their exclusion from the civil service. By 1941, ethnic Chinese made up 43 percent of the population, becoming the largest ethnic group in the country, and they continued to concentrate in the export-intensive trade, rubber, and tin industries (Kuhonta 2011). In 1946 the British promulgated the Malayan Union, which sought to transfer power from the Malay sultans in each of the states back to the crown to unite the states and grant equal citizenship rights to all of Malaya's ethnic groups, including the ethnic Chinese. The Malay elite rejected the Malayan Union, which would have meant a significant reduction in their power. They founded what became the United Malays National Organization (UMNO), the political party that has ruled Malaysia since its independence as a means of resisting the Malayan Union. The UMNO utilized the structure of the civil service at the state and village levels, which they controlled, to pressure village elders to organize grassroots activism, including widespread protests and rallies. This mobilization became the mass base for the UMNO. In the face of mass resistance, the British withdrew the Malayan Union only a few months later, replacing it with the Malayan Federation, which retained some of the power of the Malayan sultanate ruling at the state level and restricted citizenship rights for non-Malays.

The UMNO thus emerged on the eve of independence as an alliance between the Malay landed elite and the Malay peasantry, with a fully politically activated rural base. Despite the strong emphasis of the UMNO on Malay advancement, Kuhonta (2011) emphasizes that it took a relatively pragmatic stance toward ethnic Chinese. Instead of continuing to oppose citizenship rights, UMNO elite formed an economically conservative alliance with the Chinese elite, and united against the Malay and Chinese left and the growing strength of communism. The alliance rested on strong vertical organization within each community and strong horizontal organization among elites (Von Vorys 1975).

When Malaysia achieved independence in 1957, without Singapore, the newly independent state lost much of its industrial sector. Although UMNO was interested in sectoral diversification, the state initially undertook relatively little intervention in the economy. The focus of development efforts was on protection of private property; in particular, the postcolonial government was committed to protecting British business interests in Malaysia and enabling capital accumulation (Jomo and Gomez 2000). Protection of foreign property rights was reflected in the distribution of capital in the country: in 1970, foreigners held 75 percent of capital in the agricultural sector (primarily rubber and palm oil plantations), 72 percent of capital in the mining sector, 59 percent of capital in the manufacturing sector, and 60 percent of overall capital (Hirschman 1989). Ethnic Chinese held about 23 percent of overall capital, while ethnic Malays held less than 2 percent (Hirschman 1989).

While the state took on a relatively minor role in promoting the industrial sector, it was much more active in promoting agricultural development. In 1957, the government established the Federal Land Development Authority (FELDA) to implement land policy. FELDA's mandate was to create a class of smallholder, land-owning Malay farmers who would cultivate rubber or palm oil. However, unlike in Japan, South Korea, and Taiwan, where land reform involved seizing lands from plantations and distributing it to tillers, Malaysia's land policies were more modest. No major land redistribution was undertaken; efforts focused on settlement of new lands. The resettlement program was highly successful, bringing 500,000 formerly landless households into smallholder rubber and palm oil development. FELDA experimented with several different ownership schemes—block systems, cooperatives, and individual ownership—but ultimately settled on individual ownership, as the other methods proved ineffective at providing incentives to increase production.

To coordinate the overall rural development effort, the government created the Ministry of Rural Development in 1959. Headed by then-Deputy Prime Minister Abdul Razak Hussein,²⁷ the ministry was to “function as a ‘super-ministry,’ with influence over technical ministries, such as those of public works and agriculture; direct access to state party governments; and considerable leverage over financial and

²⁷ Abdul Razak Hussein later became the second Prime Ministry of Malaysia (1970–1976) and the chief architect of the New Economic Policy. His eldest son, Najib Razak, has served as the Prime Ministry of Malaysia since 2009.

administrative resources” (Kuhonta 2011, 72). It spearheaded investments in irrigation, roads, and other large-scale, rural public works programs.

To implement policy, the ministry worked through federal-, state-, and district-level rural development committees comprising civil servants, heads of technical departments, and UMNO party officials. The ministry utilized a bottom-up planning process known as the Red Book framework. District-level committees established local priorities for development spending by holding village meetings and consulting with village officials. This information would then be transmitted to ministry officials. Development committee meetings regularly “brought together civil servants and elected officials” and enabled “effective communication and coordination between bureaucracy and party” (Kuhonta 2011, 73). Razak himself would often attend these meetings to discuss any implementation bottlenecks. He also conducted field inspections of rural development projects funded through the Red Book framework. In 1962 alone, Razak attended 118 rural development committee briefings and traveled 43,000 miles throughout the country on site visits (Kuhonta 2011).

To complement large-scale rural development projects, the government also implemented assistance programs in the form of input subsidies for fertilizers, pesticides, and other planting materials. One notable effort involved irrigation projects undertaken in Muda and Kemubu, Malaysia’s “rice bowl,” which enabled the double-cropping of rice. The implementation of these assistance programs was uneven. The smallholders in the FELDA land development schemes were the largest beneficiaries, with good access to land, extension services, credit, and input subsidies. Among paddy rice farmers, the introduction of technology and input subsidies primarily benefited large land-owning farmers, raising inequality among paddy rice farmers. In general, input subsidies and technology assistance were directed toward plantation rather than food crops (Mustapha 1983).

In contrast to the state’s activist rural development agenda, it took a relatively laissez-faire approach to promoting the industrial sector. To a large degree, the state was constrained in taking an activist role by the ruling alliance between UMNO and the Malaysian Chinese Association (MCA). Any attempt to promote domestic ownership of industry would be seen as favoring one ethnic community over the other and would destabilize the ruling coalition. For example, in the early 1960s, the Minister of Agriculture and Cooperatives attempted to increase Malay ownership of rice mills by transferring the licenses of 350 Chinese rice millers to Malay rural cooperatives. This redistributive move was quickly blocked and overturned by the MCA, which threatened to withdraw from the ruling alliance (Bowie and Unger 1997). In turn, any efforts by the government to promote domestic ownership of industry without redistribution would have amounted to a strengthening of Chinese business interests, and UMNO would have struggled with its Malay base. Instead, promoting foreign ownership of industry provided a less fraught pathway to industrialization: the state could promote foreign-led industrialization without appearing to favor either ethnic group, maintaining the stability of the ruling alliance.

Thus, the state maintained relatively open trade policies, with modest tariff rates compared to other developing countries. They maintained tariff policies first set by the British, which were primarily designed to collect government revenue rather than to limit imports. Attempts to pursue import substitution through tariff policy were blocked by powerful foreign plantation and industry interests, who feared rising costs of production (Bowie and Unger 1997). Instead, the government focused on promoting industrialization through providing a strong investment climate, including tax holidays for foreign investors (Athukorala 2005).

During this period, the state began to lay the groundwork for future changes in education policy. The educational system under colonial rule was characterized by significant inequality, with English-language primary and secondary schools dominating in urban areas and ethnic Chinese occupying the majority of the seats in these schools. Rural education, by contrast, was provided in Malay with no opportunities for secondary education. The language barrier was a significant obstacle to Malay education and advancement (Kuhonta 2011). The Ministry of Education began to promote Malay as the dominant language in schools during this period but did not take many actions to enforce it. In addition, the government established the Rural & Industrial Development Authority Training Center, which later came to be known as the MARA Institute of Technology. Although the institute began on a small scale, with an

initial enrollment of only 50 students, it focused on creating a new class of professionals among rural Malays by teaching technical and analytical skills and providing business and entrepreneurship classes. By the mid-1970s, the MARA Institute of Technology would enroll 8,000 students and begin to take on an important role in closing the skills gap.

Applying the Developmental Roles and Developmental Structures Framework

In the postcolonial era, Malaysia confronted severe governance challenges driven by large interethnic inequalities. The ruling coalition, led by the UMNO, forged an alliance between Malay elite, who dominated the state and the bureaucracy, and ethnic Chinese elite, who were the primary domestic owners of capital. In bringing together this ruling alliance, the government showed an impressive ability for consultation and consensus building. However, this ruling alliance was conservative in its economic policies. Due to the alliance of landed elite and capital holders, no redistribution was pursued in either rural land policy or to benefit urban workers. The government also did not pursue much by way of industrial policy, focusing instead on protecting property rights to facilitate capital accumulation.

However, the government created an ambitious rural development agenda, which included large-scale public investments in rural infrastructure and a large land resettlement program. Implementing these policies involved confronting two main policy challenges: obtaining local information on where different types of infrastructure investments were needed, and organizing and providing incentives for the planning and implementation of a large number of rural infrastructure projects. While the technical complexity of information was low, the need for local knowledge was relatively high.

To gather information on local priorities for infrastructure investment and to monitor local policy implementation, the government developed an impressive ability to consult both horizontally across elite and vertically between federal and local branches of government. Development committees at every tier of government (federal, provincial, and local) regularly brought together politicians, civil servants, and technical departments to consult on project planning and implementation. Just because committees are formed, however, does not mean that they will be effective. They were effective in this context because the central government made their committees' success a priority. This was achieved by appointment of the Deputy Prime Minister as the head of the Ministry of Rural Development, and by the active role that he took in monitoring the outcomes of government initiatives at the local level. In other words, local governments in the periphery were given a voice in the development agenda through the planning process, but they also acted as faithful agents in implementing the central government's agenda due to strong accountability relationships within the government.

The developmental roles taken on by the state in the 1950s and 1960s, while ambitious in regard to the level of public spending and investment in rural development, did not test the ability of the government to implement policies with a high degree of technical information. The government demonstrated "a formidable institutional infrastructure ... that could disburse funds efficiently, but it did not effect [sic] deep structural change in terms of economic relations or improved capacities and skills of the rural Malays" (Kuhonta 2011, 75). Indeed, the skills gap proved a formidable barrier to expanding the modern sector.

Neither did the developmental roles require the political capability to pursue redistributive policies; the conservative alliance between the landed elite and capital ensured that heavily redistributive policies were not pursued in either the agricultural or industrial sector. As a result, inequality in Malaysia ticked up during the 1960s (see Figure 4.2).

New Economic Policy, 1971–1985

Policy Content and Implementation

The May 1969 ethnic riots in Kuala Lumpur were a watershed moment in Malaysian politics, and the New Economic Policy (NEP) was formulated in the aftermath. From the perspective of the government, the primary cause of the riots was that the Malay poor felt increasingly left out of the Malaysian

economy: indeed, in 1970, 65 percent of Malays were classified as poor (Kuhonta 2011). The NEP sought to address this by setting a target to transfer 30 percent of the nation's wealth to the Malays by 1990. The policy itself was developed in secrecy, led by the EPU in the Prime Minister's office. Consultations were narrow and included primarily the EPU, Prime Minister Razak, and elite UMNO officials (Leong 1992).

The NEP marked a fundamental change in the role of the state in the economy, with the state now taking considerably more responsibility in directing the development trajectory. The NEP also marked a departure from the state's earlier exclusive focus on rural development. It now explicitly sought to encourage movement from rural to modern, urban sectors. The NEP also had a significant redistributive component, which was designed to increase Malay participation in the modern sector. Although the focus was more on industrialization, the government did not abandon the prior rural development agenda, particularly since this was seen as crucial to the advancement of ethnic Malays.

The NEP had a redistributive agenda focused on increasing Malay business ownership and employment in modern sectors, and on improving educational systems to reduce the skills gap that prevented many Malay youth from entering modern sectors. With this in mind, the government set two major targets: (1) ethnic Malays would manage and own at least 30 percent of the total commercial and industrial activities by 1990 as compared to 2.4 percent in 1970, and (2) employment in the modern, urban sectors would reflect the ethnic composition of the population. To reach these targets, the government set up trust companies for ethnic Malays and forced foreign companies to sell stock at discounted rates to the holding companies, thereby increasing Malay ownership (Khan 2002). Employment quotas set up affirmative action in hiring for ethnic Malays. However, the crucial element of the NEP's agenda was the assumption that redistribution would occur through a "growing pie," with Malays capturing a larger share of the growth rather than merely through redistribution.

Education policy was an important component of the NEP and its efforts to address the skills gap. Reform was one of the first actions taken by the government in the immediate aftermath of the 1969 riots. Just two months later the Ministry of Education decreed that English-language schools would convert to Malay instruction one grade at a time (Kuhonta 2011). In addition to the language barrier that had largely prevented poor Malays from attending secondary school, there was a significant urban-rural gap in education quality. To address this, NEP education policy had a pro-rural slant. Although funding for schools is based on the number of students, rural areas receive an increase in funding relative to the scale. The government implemented a textbook-loan scheme, a nutrition program, a milk program, and scholarships to address poverty in school. To recruit and maintain well-trained teachers, the Ministry of Education required teachers to remain in the countryside for at least five years, and provided subsidized housing for teachers and a 5 percent pay raise for those teaching in particularly remote areas (Kuhonta 2011). The government also expanded emphasis on enrolling students in the MARA Institute of Technology, and by 1975 8,000 students were enrolled (Kuhonta 2011). This institute was key to providing rural residents with skills to transfer into the modern sector.

By 1980, the government began to more seriously promote the expansion of heavy industries. The Minister of Trade and Industry, Dr. Mahathir Mohamad,²⁸ announced a heavy industries policy initiative designed to support import-substituting industrialization. In announcing the new policy, known as Mahathir's Look East Policy, Mahathir "pointed to the Japanese 'economic miracle' and the achievements of South Korea" (Bowie and Unger 1997, 84). In 1980, the government formed the Heavy Industries Corporation of Malaysia (HICOM), a public-sector holding company, to partner with foreign companies setting up industries in petrochemicals, iron and steel, cement, paper products, machinery and equipment, building materials, and so forth. By 1987, there were 867 corporate public enterprises in Malaysia, with more than a third in manufacturing (Athukorala 2005). Malay civil servants often served as managers in these companies to help fulfill the Malay ownership and employment requirements, and because there was still a general lack of domestic management skills among the Malay private sector. Tariff rates also increased during this period. However, the government also set up Free Trade Zones, which were exempt from customs regulations and catered to export markets.

²⁸ Dr. Mahathir Mohamad would later become Malaysia's fourth Prime Minister (1981–2003).

Two precipitating events enabled the expansion of state ownership. First, capital holders had pulled back from the redistributive aspects of the NEP and reduced the pace of investments in Malaysia. Many ethnic-Chinese entrepreneurs redirected investments toward such nonproductive uses as real estate speculation and financial instruments (Bowie and Unger 1997). Foreign investment also slowed down, growing at less than one-third of the 10 percent rate targeted by the government (Bowie and Unger 1997). Second, the oil price shock of 1979, and the windfall profits that Malaysia captured as an oil producer, expanded the state's financial abilities to pursue heavy state participation and ownership.

Meanwhile, the government continued its emphasis on rural development, speeding up the FELDA land resettlement schemes. Consistent with the redistributive agenda, the state began to implement programs focused more on input subsidies for farmers. These programs included subsidies for technical advice, replanting, fertilizers, pesticides, planting materials and chemicals, irrigation and drainage, and provision of credit at low interest rates. In addition to input subsidies, the government subsidized output, particularly of rice, by setting a guaranteed price minimum regardless of the prevailing market price. Between 1970 and 1980, rice output grew by 4 percent annually (Mustapha 1983).

Applying the Developmental Roles and Developmental Structures Framework

In preparing to enact its new agenda, UMNO undertook large-scale organizational reforms. First, the UMNO began to move away from its "original organizational complexity toward a more personalistic, even sultanistic, authority structure" (Kuhonta 2011, 82). In the immediate aftermath of the riots, Prime Minister Razak suspended parliamentary democracy and centralized power in the Prime Minister's office. The UMNO also moved to strengthen internal party discipline, reducing the frequency of party elections and hiring a full-time staff of party organizers at all levels.

Second, UMNO strengthened relationships between local party members and citizens, raising the salaries of Members of Parliament (MPs) to create incentives to make more field trips to their districts and to have more contact with local citizens. The party made clear to MPs that they could be replaced if they did not sufficiently interact with the party base. The Key Performance Index (KPI) was a major innovation in the party's ability to monitor MP performance. The KPI is a report card that MPs submit to party headquarters on a monthly basis, indicating how many times they traveled to their home district, what problems they discussed with constituents, and how programs and project implementation is proceeding within the district (Kuhonta 2011). Third, Razak sought to improve confidence in the bureaucracy's ability to advance a pro-Malay development agenda. The government increased salaries in the civil service and launched an extensive campaign to root out corruption within the government (Kuhonta, 2011).

After centralizing power, the UMNO began to re-establish a new ruling alliance—the Barisan Nasional (BN), or National Front—across opposition groups, with itself as the lead. This alliance provided a mechanism for secret consultation among elites, with the Prime Minister making final decisions. The newly centralized government moved to adopt a new economic strategy, one in which the government would play a much more significant role.

The centralization of power in the UMNO enabled the pursuit of a more redistributive policy agenda under the NEP. However, the redistributive elements of the NEP also created uncertainty for investors, and caused them to scale back investments. The government stepped in as an active investor to fill the gap. It established trusts allowing the class of Malay entrepreneurs and public companies, which was still small, to step in and pick up some of the investment slack. However, Malay ownership quotas created opportunities for UMNO leaders to expand their own holdings and widened opportunities for corrupt practices (Bowie and Unger 1997). Nonetheless, the NEP resulted in the transfer of 20.3 percent of the country's corporate assets to Malays by 1990, up from 2 percent in 1970 (Leong 1992). Although this did not meet the government's original target of 30 percent, it reflects a significant redistribution of wealth. It is hence no surprise that inequality declined dramatically in Malaysia during the 1970s (see Figure 3.2).

Overall, as in the postcolonial development period, the Malaysian government showed an impressive ability to execute its development agenda, monitor its implementation, and problem solve to achieve its desired outcomes. The education reforms are the best example of these strengths. The government had a singular focus on closing the rural-urban gap in education, and did so with remarkable effectiveness. Innovative strategies focused on keeping teachers in rural areas and increasing access to secondary and tertiary education show that the state was not just changing the rules on the books, but was actively seeking out solutions to improving rural education. Tight feedback loops between local and federal officials, particularly within the UMNO, improved policy implementation: central party officials held MPs accountable for reaching the grassroots and gathering feedback on policy implementation.

The government also demonstrated increased political capabilities to implement a redistributive agenda. However, this was due to the increasing centralization of power in the UMNO and the collapse of the multiethnic ruling coalition from the postindependence period. In effect, the changing political settlement allowed the state to more forcefully redistribute wealth to and provide opportunities for the rural Malay population. Through its rural development policies, the state also increased its control of the countryside by expanding land resettlement schemes, which became bastions of UMNO support, and by heavy state involvement in price setting and agricultural input subsidies.

However, the government still did not pursue policies with a high degree of technical information. Industrial policy was clumsy and often implemented without consultation with investors. Oil profits enabled the government to fill the investment gap. Yet, the government did not consult and collaborate with business interests through policies such as those enacted in Japan and South Korea, though this was their goal. As a result, export industries were often enclaved, resulting in low levels of employment and few linkages with the domestic economy.

National Development Policy and Privatization, 1986–1996

Policy Content and Implementation

The next era in Malaysian economic policy making was brought about by the collapse in commodity prices in the mid-1980s. Prices slumped for many of the commodities that Malaysia produced in abundance, including rubber, tin, palm oil, and oil. The effects were particularly devastating for Malaysia's new heavy industries initiative: "... just as they brought their first products (cars, steel, and so forth) to market, demand fell" (Bowie and Unger 1997, 86). Almost all of the HICOM units suffered losses.

Despite the disappointment in the performance of state-owned enterprises, it is important to note that Malaysia at this point had already achieved remarkable growth in the industrial sector, with manufacturing contributing only 9 percent to GDP in 1965 but 19 percent by 1988 (Jomo 1993b). Manufactured exports had also risen, increasing from 6 percent to 45 percent over the same period (Jomo 1993b). However, linkages to the domestic economy within the manufacturing sector remained weak, with Malaysian manufacturers remaining dependent on finished and unfinished products from abroad (O'Brien 1993). Investments in rural development had also begun to pay off; agricultural productivity rose by 60 percent between 1975 and 1986.²⁹ Education policies had perhaps not taken off as much as was hoped, with a literacy rate of only 60 percent by 1980 (Jomo 1993b). This was far below rates in the East Asian NICs during the same period. However, Malaysia had also inherited more difficult initial conditions, given the language divisions and deep inequalities in the colonial education system compared with the relatively homogeneous populations of South Korea and Taiwan. Thus, although Malaysia skeptics still point to the skills gap in the Malaysian workforce during this period, it is also true that skills had expanded greatly during the prior decades.

²⁹ Author's calculations using data from Timmer, de Vries, and de Vries (2015).

The formulation of the National Development Policy (NDP) was quite different than the formulation of the NEP. Where the NEP was created quickly and behind closed doors in the aftermath of the race riots, the NDP was established over several years in consultation with a wide range of actors. Leong (1992) argues that the NDP was developed in three phases. In the first phase, interest groups and political parties debated the strengths and weaknesses of the NEP. While this began as a period of open public debate, this was shut down in 1987 when 106 active politicians and opposition leaders were detained under the Internal Security Act (Leong 1992).

In the second phase, the government launched the National Economic Consultative Council (NECC). Launched in 1989 with 150 members, the NECC included politicians from all political parties (even opposition parties), representatives from chambers of commerce, government officials, corporate leaders, economists, and other experts. The council's secretariat was the EPU of the Prime Minister's office. The NECC was charged with debating and formulating policy along five key policy areas: data standardization, poverty elimination, restructuring of society, the national economy in the context of the international environment, and the development of human resources. A major cleavage within the NECC concerned the strengths and weaknesses of the NEP. Many debates became zero-sum arguments cleaved along ethnic lines, with representatives of Malay interest groups arguing that the NEP had not gone far enough and that key targets had still not been achieved (for instance, the 30 percent ownership target), and representatives from Chinese interest groups arguing for a scaling back of NEP policies. In the end, the NECC developed policy proposals for each of the policy areas. It also proposed setting up an independent commission in charge of monitoring policy implementation. In the end, the EPU and the Prime Minister's office assumed control of the official planning process; many of the ideas of the NECC were scrapped, including that of the independent monitoring commission (Leong 1992).

Ultimately, the NDP reflected the direction of the Prime Minister's office. The commodity price decline and the poor performance of the HICOM units had motivated a push toward privatization. As noted by Prime Minister Mahathir, "companies and services owned and managed by [the] government have been less successful or have run at a loss because the government's management methods differ greatly from those of the private sector" (as quoted in Gomez and Jomo 1999, 80). The privatization plan aimed to utilize more private—rather than public—investment to fuel growth and to decrease the financial and administrative burden that state ownership imposed on the government.

Mahathir saw the move to privatization as consistent with the NEP's focus on pro-Malay redistribution, viewing it as a chance for Malays to acquire and manage privatized entities (Gomez and Jomo 1999). By the mid-1990s, state ownership in manufacturing was limited to a few politically sensitive projects in car manufacturing, petrochemicals, iron and steel, and cement (Khan 2002). The government claimed that the overall privatization push, including contracting out service delivery in many areas, saved the government RM4.8 billion in operating expenditures, RM17 billion in development expenditures, and RM37.7 billion in capital expenditures annually (Gomez and Jomo 1999), though these figures have never been confirmed.

In line with the privatization effort, the government also reduced barriers to trade. Tariff increases from the 1970s and 1980s were reversed. Malaysia moved away from import-substituting industrialization, emphasizing export markets rather than producing for the domestic market to substitute for imports (Athukorala 2005). The government also emphasized macroeconomic stability, reducing government expenditures and broadening the tax base throughout the period to keep budget deficits low (Khan 2002). The significant depreciation of the Malaysian ringgit after 1985 also made a significant difference in the competitiveness of Malaysian exports.

While encouraging the entry and growth of large-scale foreign enterprises, industrial policy did little to promote the growth of small- and medium-scale enterprises. In general, "efforts to promote small industries in Malaysia have been weak, uncoordinated, unsustainable and uneven" (Jomo 1993a, 5). Small industries face poor access to credit, as well as deficiencies in technology, management training, marketing, and subcontracting opportunities.

Applying the Developmental Roles and Developmental Structures Framework

While the NEP era coincided with a growing authoritarianism within Malaysia and the centralization of power within the UMNO political party, from the mid-1980s there was a growing personalization of power in Prime Minister Mahathir Mohamad (Slater 2003). Even as the UMNO took on a more authoritarian role within Malaysia, it had retained intraparty competition through the institution of three-year election cycles, and allowed for internal dissent and debate. However, Mahathir was almost unseated through intraparty competition in 1987, and he later used his authority to “systematically rig UMNO’s internal election procedures” (Slater 2003, 89). The combination of the consolidation of his personal power and the substantial infrastructural power that UMNO had built at the grassroots level made Mahathir a uniquely powerful figure.³⁰ Reflecting this power, Mahathir stripped many organizations within Malaysia’s government of true decision-making authority.

Given this, it is no surprise that the recommendations of the NECC were ultimately discarded in favor of policies written by the Prime Minister’s office. While the NECC showed an impressive ability to bring many actors together across society to debate and deliberate policy, the government did not absorb the fruits of this consultation into policy formulation, undermining the credibility of the NECC as a consultation institution. Similarly, line ministries within the government were circumvented during the privatization process itself, and privatization was run through the Prime Minister’s office.

Privatization and contracting out government services were used as opportunities to expand patronage during the 1990s, as contracts often went to UMNO-linked businesses (Gomez and Jomo 1999; Slater 2003). The rising Malay business community—the effect of not only privatization but also of the NEP Malay ownership requirements—further changed the party structure. Where the UMNO had once relied on local activists, such as teachers and village headman in rural districts, for support, “money politics” began to take over, with Malay businessmen bankrolling the UMNO during the 1990 elections. In addition to weakening ties to its rural base, the rise of the Malay business class as a source of elections financing also reduced UMNO’s dependence on the alliance with the MCA for electoral campaign financing. Whereas the Chinese business community had once been the sole source of domestic capital, this was increasingly less true after the pro-Malay redistributions (Bowie and Unger 1997).

Mahathir’s Look East orientation also inspired the bureaucracy to improve efficiency and performance. Government agencies began to require employees to use clocks to record work hours, wear name tags, and prioritize punctuality (Lesley 2014). Consistent with efforts to emulate Japan and South Korea, Mahathir also sought to increase consultation between business and civil servants. He formed the Malaysian Business Council as a forum for bringing together business leaders and civil servants from various agencies to consult on policy formulation and implementation (Mansor and Ariffin 2014). Nonetheless, the increase in patronage and rent-seeking within the government fed the public perception that civil servants were corrupt and the bureaucracy weak.

Another area where institutional capabilities were weak, once again, was in undertaking the complex roles necessary to facilitate domestic linkages. The increasing attention to attracting foreign firms and to pursuing export-led growth rather than import-substitution industrialization may have made the task of developing local linkages even more difficult than in prior eras, as foreign firms and firms producing for export (versus for domestic markets) were the least likely to use local inputs (O’Brien 1993). Personalistic rule increasingly meant that foreign firms had to cultivate personal relationships with UMNO officials to obtain manufacturing and export licenses; consultation between business and government to improve local linkages was more focused on obtaining licenses than on information sharing.

³⁰ Typically, personalization of power within autocracies is seen early in a regime, when institutions are weak. Malaysia during this period is unique in having the combination of a highly institutionalized political party and a personalistic regime (Slater 2003).

Recovery from the Asian Financial Crisis, 1996–mid-2000s

Policy Content and Implementation

On July 14, 1997, a chain of events was set off that would fundamentally change the political economies across all of Southeast Asia, beginning with the abandonment of the informal peg of the Thai baht to the dollar. In the end, by 1998, capital outflows and currency speculations led to a massive depreciation of the ringgit and a collapse in GDP of nearly 8 percent in Malaysia (Pepinsky 2009). To understand the government approach to recovery from the AFC, it is important to understand the political coalition underpinning the regime at the time. A cross-class coalition between Malay masses and the new class of Malay business elite had emerged in the wake of the NEP and privatization eras. The regime has utilized repression to undermine threats to UMNO dominance.³¹

Pepinsky (2009) lays out a compelling case for how this cross-class coalition underlying the regime shaped the government's reaction to the AFC. In contrast to the International Monetary Funds' (IMFs') recommendations on how to manage the crisis, Malaysia responded by continuing high levels of government spending, laying out a new set of policies to redistribute wealth to the Malay poor, banning capital outflows, and pegging the ringgit to the dollar. Although government officials announced early on their intentions to scale back government spending, they faced strong opposition from the business interests that benefited from government contracting and quickly reversed policies. The government continued infrastructure spending at a strong pace. While officials cut the overall budget, they did not trim expenditures on social programs targeted to the Malay masses. Mahathir encouraged government agencies to expand countercyclical spending by dispersing funds through contracts, arguing that this would protect Malay business interests in the same spirit as did the NEP. Expansionary fiscal policy was soon linked with tax cuts for "strategic" firms; the effect was a RM16.66 billion deficit in 1999 (Pepinsky 2009).

The government also reacted in a highly interventionist fashion to protect stock prices, which had plunged by 79 percent between February 1997 and September 1998 (Pepinsky 2009). The government itself used RM30 million in public funds to purchase shares in "strategically important" firms. Of course, many of these firms were those with political links. This move motivated foreign investors to sell off even more assets, as it was seen as a means of saving connected firms from market discipline (Pepinsky 2009). In the end, the Malaysian response to the AFC relied on the use of public funds to bail out or otherwise support politically connected Malay business interests.

Further, in 1998, Malaysia enacted a ban on capital outflows (but not inflows) and pegged the currency to the dollar. This afforded policy makers the ability to maintain expansionary fiscal policy, continuing to support Malay business interests and the redistributive social programs favored by the Malay masses and avoiding politically unpopular austerity and subsidy cuts as was pursued in Indonesia. This effectively enabled the regime to shore up rather than undermine its bases of support, as happened in Soeharto's Indonesia in the wake of the AFC (Pepinsky 2009).

Applying the Developmental Roles and Developmental Structures Framework

The reaction to the AFC reflected the position of the coalition that supported the regime, which had been strengthened through the NEP and NDP periods. The new coalition underpinning the regime relied on exchange relationships between UMNO and Malay masses and between UMNO and Malay business interests. Malay masses provided electoral support for UMNO, and UMNO ensured that public policies favor Malays.³² This exchange relationship was preserved through the implicit threat that each group

³¹ Challenges come primarily from the Malay-based Pan-Malaysian Islamic Party, which advocates the creation of an Islamic state in Malaysia, and the Democratic Action Party, which, though predominately Chinese, offers a multiethnic social democratic platform.

³² For example, affirmative action in Malay employment and university entrance, the distribution of land to Malays through the land resettlement schemes, the use of the Malay language in schools, and, of course, the corporate equity regulations for Malay ownership all enforce pro-Malay redistribution. Because Malays constituted the majority of the poor in the 1960s, these

wields. Malays could punish the regime by voting for opposition parties. Meanwhile, the regime acts to limit true opposition in elections by gerrymandering, making opposition campaigning difficult to impossible, and using repressive legislation to detain and jail political opponents. A similar exchange relationship exists between the new Malay business elite and UMNO. Pro-Malay corporate and financial policies have created a class of Malay business elite, who fund UMNO electoral campaigns. The logic behind the exchange among the new Malay rich and the regime is clear and persists today: “UMNO politicians reward loyalty to the party with favorable access to business opportunities, distributed through tenders, privatization, stock offers, and party-held corporations” (Pepinsky 2009, 76).³³ The threat of potentially withholding this favoritism keeps Malay business interests loyal to the regime.

This coalition pushed Malaysia to pursue a recovery plan counter to the course counseled by the IMF. Austerity and contraction in government spending on social programs would have entailed redistributing wealth away from UMNO’s core constituencies. What began as a strength (the state’s ability to pursue policies with redistributive content) was also emerging as a weakness (the state’s inability to reverse course). This was reflected by Malaysia’s budget negotiations in the wake of the crisis. The government initially planned to delay major infrastructure projects and cut spending but quickly rolled back these proposals in the face of resistance from Malay business interests, who benefitted from the contracts (Pepinsky 2009). Ultimately, the controversial policy course followed by Malaysia may have served it well economically, as its recovery in from 1999 to 2000 was among the strongest of the Asian crisis economies. However, it also illustrated how the political coalitions constrained the policy space.

The “1Malaysia” Campaign, Government Transformation, and Economic Transformation, Mid-2000s to the Present

Policy Content and Implementation

A handful of watershed events in Malaysian history have prompted large-scale transformations of government structures and policies. The 1969 riots were one such event, and the 2008 elections were another. In 2008 Malaysia’s ruling coalition, the BN—of which UMNO is the dominant member—were dealt their worst electoral performance in history. For the first time since the formation of the BN in 1969, it failed to achieve two-thirds majority in parliament and lost 5 of 13 state legislatures to opposition parties. In prior years, only one state legislature was dominated by opposition parties. The share of Malaysians satisfied with the “way things are going in the country” sank from 72 percent to 26 percent between 2006 and 2008 (Iyer 2011, 1). Although Malaysia had recovered from the AFC, growth rates had fallen: Where per capita income in Malaysia averaged 6.4 percent annual growth between 1990 and 1997, per capita income growth averaged only 3.5 percent annually between 2000 and 2007 (World Bank 2015). In addition to weak growth, income inequality had reversed course from its steady decline and begun to climb (see Figure 3.2). Malaysians were also dissatisfied with the rising cost of living and poor service delivery.

In response to its weak electoral performance, UMNO forced Prime Minister Badawi, the handpicked successor of Mahathir, to step down. Deputy Prime Minister Najib Razak, who assumed office in 2009, was the son of former Prime Minister Abdul Razak Hussein. Hussein, in turn, was the second Prime Minister of Malaysia, the chief architect of the NEP, and the former head of the Ministry of Rural Development. This ministry was responsible for the large-scale successful rural investment programs initiated in the 1950s and 1960s. Razak assumed office in 2009 with a mission to regain public support for UMNO. Najib sought to “upset the status quo,” a move he thought was necessary to achieve Malaysia’s goal of becoming a high-income country by 2020 (Lesley 2014, 3).

pro-Malay redistributions significantly reduced overall inequality in the country. In addition, social and economic policies have done little to address poverty within the ethnic-Chinese and Indian communities in Malaysia.

³³ By contrast, Chinese business owners had already reacted to Malay favoritism by beginning to move capital abroad (Pepinsky 2009).

Najib Razak launched the “1Malaysia” campaign, which was designed to promote ethnic harmony and economic growth. Part of 1Malaysia included a commitment to end the affirmative action policies first implemented under NEP that had long favored ethnic Malays, and to broaden social programs to cover the poorest 40 percent of the population, regardless of ethnicity (Lesley 2014). Reflecting this new commitment to achieve growth and equity for all Malays, Najib created a new cabinet post, the Minister of National Unity and Performance. He appointed as minister Koh Tsu Koon, a Malaysian of Chinese ethnic descent and the president of the minority Gerakan Party in the BN coalition. Koh was from Penang, a traditional opposition stronghold, but also one of Malaysia’s most economically successful provinces and the center of the Malaysian electronics industry. Naming a non-UMNO leader of Chinese ethnic descent to the new high-profile position signaled Najib’s commitment to change.

Koh set about planning a new approach to public management, focused on using performance indicators and improving service delivery. He brought in Idris Jala, a former executive at Shell Oil Company and the architect of the Malaysian Airlines’ stunning turnaround, to help with planning. Jala proposed an innovative format adapted from his time at Shell: a lab methodology wherein leaders from many government agencies would be brought together for six to eight weeks and charged with developing targets and initiatives. A key focus during these sessions was getting a sense of what the public wanted and understanding public perceptions. The government had commissioned a large-scale public perceptions survey after the poor electoral results in 2008; the poll indicated that the public were most concerned with crime, education, corruption, unity, and the economy (Lesley 2014).

However, there was also a concern about focusing too much on immediate public opinion and not enough on the overall direction of the country. In the meetings, Cabinet members were anonymously polled on their own priorities, and Najib encouraged open discussion. In the end, the Cabinet decided on six priorities: reducing crime, fighting corruption, improving student outcomes, raising the living standards of low-income households, bolstering rural development, and improving urban public transportation. Prioritization of rural development was particularly interesting, as it was not raised in either media coverage or in the public perceptions survey as a high priority. However, Cabinet members thought that “both the polls and the media coverage underrepresented the opinions and needs of Malaysians living outside urban areas” (Lesley 2014, 7).

Out of this planning effort, Najib formed the Performance Management and Delivery Unit (referred to as Pemandu). Its sole purpose was to ensure implementation of the government’s five priorities. In the past, the government would have set up a task force to follow up on priorities. However, task forces tended to meet only on occasion, and often their members were kept busy with other demands. Pemandu had its own staff dedicated to the sole purpose of implementation. Koh appointed Idris Jala as Pemandu’s leader. Idris agreed to take the post on the condition that he could remain politically unaffiliated, would serve as a full minister and be the equal of the other ministers with whom he interacted, and could recruit from the private sector and pay higher salaries than did the rest of the civil service (Lesley 2014).

Once Pemandu was formed, it returned to the lab methodology to further refine priorities and start to form performance indicators. In all, eight labs were held, one for each of the priority areas, one on 1Malaysia generally, and one on data management. In all, over 250 civil servants from across the government participated (Lesley 2014). The government then arranged Open Days to present the strategies to the public and gather feedback. Large public sessions were held and public comments invited on the plans.

In parallel with the Government Transformation effort embodied in Pemandu, Najib launched the planning process for what became the Economic Transformation Programme (ETP). The central goal of the ETP was to raise annual per capita income above \$15,000 by 2020 (Government of Malaysia 2015). A major question for the NTP was how to avoid the middle-income trap of being neither a low-cost nor a high-value-add producer. In a similar format to the Government Transformation Programme, the ETP identified 12 National Key Economic Areas. These areas were identified based on their potential to contribute to gross national income, based on global and national growth rates for different sectors (Sabel and Jordan 2015). The National Economic Advisory Council consulted widely with leaders of private-

sector companies, trade unions, leaders of all political parties, and all provincial governments. In all, over 11,000 Malaysians were consulted to craft the ETP (Lesley 2014). The 12 key economic areas developed through this process were:

- Oil, gas, and energy
- Palm oil and rubber
- Financial services
- Tourism
- Business services
- Electronics
- Wholesale and retail
- Education
- Healthcare
- Communications content and infrastructure
- Agriculture
- Greater Kuala Lumpur

It was immediately apparent from the 12 key economic areas that Malaysia's industrial policy no longer focused exclusively on industrialization per se. Equal emphasis was placed on increasing productivity and value-add in Malaysia's traditional sectors, such as agriculture, palm oil, rubber, and oil and gas. This in itself is something of an innovation. Malaysia has long struggled to upgrade its electronics industry and the manufacturing sector overall. By contrast, its commodity-producing sectors have become increasingly technologically sophisticated and innovative (for example, enhanced recovery in oil and gas, increased use of technology and mechanization in the harvesting and cultivation of palm oil). Upgrading within Malaysia's traditionally strong commodity-based export sectors may offer better prospects for economic success than placing sole emphasis on its flagging electronics sector. This sector has suffered not only under conditions of low linkages but also due to the dominance of China in low-cost electronics manufacturing.

Applying the Developmental Roles and Developmental Structures Framework

There were many innovations in the creation of Pemandu, from the method of setting country priorities to the means of monitoring project implementation. In many ways, these approaches were constrained by Malaysia's existing political economy. First, perhaps the biggest innovation was the early and deep involvement the government sought on policy formulation and setting priorities. This contrasted dramatically with the closed-door approach to developing the NEP. While the government had sought broad and early input when developing the NDP, they also disregarded much of the input in the final plan, particularly calls to set up an independent unit for monitoring policy implementation. Notably, consultation in policy planning for the Government and Economic Transformation Programmes involved a wide range of actors from across the civil service, from every Cabinet member, from civil society, and from the private sector. And, the government largely adopted the results of this consultation process.

The lab methodology employed during the planning process was a significant governance innovation. Several specific features of the lab methodology, and the institutional strengths it developed, are worth discussing in detail. The first is that they supplied the government with fresh ideas and information to inform policy planning by bringing together actors from different agencies and backgrounds who would not normally interface. The second is that the government ensured that the lab sessions were incorporated into the normal budget-planning process. Halfway into the sessions, the lab group met with senior officials in the EPU to discuss budget constraints and their estimates off the cost of their policy ideas. This meeting led to revisions in project scope to match the budget, and helped to prevent the idea-sharing format of the labs from becoming separated from the realities of budget constraints (Sabel and Jordan 2015).

Such early and deep consultation in the policy-planning process ensured that the whole Cabinet bought into the plans once they were finally formed. Linking this process and goal setting with budgeting early on ensured that finance departments could veto policy proposals later on. The effort and expense of setting up these planning sessions was not small: the government had to suspend normal procurement rules to cover the costs of the sessions.

The Pemandu model also further developed Malaysia's institutional capacity for monitoring policy implementation. It was particularly effective in monitoring things such as large-scale investment projects. Such projects require large capital investments, can be subject to unforeseen complications, and require coordination of public and private enterprises and (potentially) coordination across tiers of government and across line ministries. Pemandu's process of breaking a project down into intermediate milestones and easing coordination problems, for example, was highly effective in facilitating the building of Kuala Lumpur's mass rapid transit system (Sabel and Jordan 2015). It is no wonder that the service delivery unit model has attracted the attention of countries like Indonesia and Tanzania.

In the aftermath of the 2008 elections, the Malaysian government also cultivated a strong capacity for problem solving. Pemandu encouraged problems with policy implementation to be raised up to the highest level of government and addressed through consultation and discussion. A core tenet of Idris Jala's approach to running Pemandu is the "70–30 rule," or the idea that only about 30 percent of initial plans are implemented exactly as conceived in the labs and the remaining 70 percent are revised during policy implementation.

However, Pemandu and the Government and Economic Transformation Programs are limited by the political economy context. Part of the success of Pemandu in improving consultation, monitoring, and problem solving no doubt lies not just in the mechanics of how it is designed but also in its elevation to the highest tier of government. This is evidenced by the decision to appoint Idris as a full minister equal to all others that he deals with in addressing policy implementation, and by the support his ministry receives from Najib. While Pemandu has helped the government to deliver on specific projects, it has proven unwilling and unable to tackle vested-interested and deeper social problems. For example, the initial promise to gear social programs toward the poorest 40 percent regardless of ethnicity has not been implemented in practice, and the pro-Malay bias in social policy remains. In addition, little has been done to address corruption in government or the ties between business and government, and Malaysia is now rocked in a corruption scandal involving a reported \$3.5 billion in assets stolen from the country's development fund.

Discussion of the Malaysian Case

Using the developmental roles and developmental structures framework, I show that Malaysia has been most successful in overcoming development challenges that concern (1) consultation, (2) implementing policies requiring a large number of actors and transactions, (3) monitoring policy implementation, (4) gathering local information to improve policy formulation, and (5) problem solving. In addition, Malaysia has pursued development policies with significant redistributive content, resulting in a formidable reduction in inequality and an overall rise in living standards for the poor. However, the ethnic basis of Malaysia's ruling coalition has limited the state's willingness and ability to implement development policies that would benefit the non-Malay poor, a significant weakness. Moreover, Malaysia was far less successful at implementing policies that required informational complexity, such as the ability to promote linkages between high-technology export firms and local suppliers. The fact that those Malaysian business interests that the state did consult with were not themselves particularly high capacity—having been put in business in many cases by the state itself—perhaps explains why business-state networks did not achieve the degree of upgrading attained by South Korea and Taiwan.

Malaysia also offers examples of how to successfully implement policies even when bureaucratic capacity is weak and improve organizational capabilities over time. For example, when Malaysia began its large-scale rural development effort in the 1950s and 1960s, the government bureaucracy lacked strong mechanisms for monitoring policy implementation and acquiring the local knowledge needed to make smart infrastructure investments. By making Deputy Prime Minister Razak the head of the Ministry of Rural Development, the government showed its commitment to its rural development strategy. Razak developed capability for consultation to collect local information and for monitoring project implementation by visiting project sites himself. Over time, his surprise project visits became both an institutionalized mechanism of policy planning for local infrastructure projects in the Red Book process and a means of project monitoring. Local party officials became responsible for collecting citizen feedback on policy priorities and policy implementation and transmitting that information to national party officials, who could communicate to the government. This example also illustrates how the local organizational strength of political parties can be used to facilitate accountability, even without a competitive elections framework. Pemandu offers a compelling example of how Malaysia has improved its organizational capacity for confronting development challenges.

The coalition between the rural Malay peasantry and Malay business interests has clearly shaped the development policies Malaysia has pursued, whether they be establishing the NDP or reacting to the AFC. The coalition has also constrained policy options, for example, by limiting Pemandu's ability to pursue a broadening of Malaysia's social programs to include non-Malay poor. As much as this coalition has shaped the state's willingness and political capacity to pursue policies with different distributional consequences, it is evident that the development policies themselves have acted to gradually change the strength of different social actors over time.

In the concluding section of this paper, I lay out a set of questions inspired by the Malaysia case to guide future research on how the state can play a transformative role in the development process.

7. CONCLUSIONS

The impressive growth and transformation of economies across East Asia have led scholars and development practitioners to ask whether the specific policies and governance models used in these states can be transferred to other countries. Indeed, as noted in the Introduction, governance in models in East Asia has inspired diffusion and mimicry across the developing world. For example, Ethiopia's Agricultural Transformation Agency, established in 2010, is modeled on South Korea's Economic Planning Board. Tanzania's President's Delivery Bureau and Indonesia's Presidential Delivery Unit for Development Monitoring and Oversight were inspired by Malaysia's Pemandu, which in turn was inspired by efforts to improve service delivery in the United Kingdom. If different institutions create incentives for different behaviors, thus leading to different outcomes, then the key to development is finding the right institutional frameworks. Examining these frameworks in countries that have succeeded economically, then, seems to be a promising method to identify institutional "best practices."

Whether these governance models can be successfully imported into new locations is an active area of debate. On the one hand, international development institutions have been placing increased emphasis on public-sector institutional reform as a key component of development. Between 2000 and 2010, projects supporting public-sector institutional reforms comprised 65 percent of the World Bank's operations (Andrews 2013). Additionally, public-sector reforms have long been seen as critical to the success of foreign aid (for example, Burnside and Dollar 1997). On the other hand, political economy analyzes the question of whether institutional models can be successfully adopted in settings other than where they originated (for example, Kohli 2004). In a similar vein, Evans (2004) cautions against "institutional monocropping," whereby institutional models are assumed to transcend cultures and context. Andrews (2013) argues that similar institutional reforms produce quite different results across contexts. Efforts at institutional reforms that fail to improve governance may erode institutional capacity over time (Andrews 2013).³⁴

It is difficult to resolve questions about whether and why institutional frameworks can be successfully adopted across different contexts without understanding which institutional frameworks have been successful in the countries where they have been adopted. This paper began by reviewing the supposedly essential characteristics of developmental states, including: (1) cohesive, capable, and autonomous bureaucracies; (2) lead agencies; (3) dense, accountable networks between states and businesses; (4) exclusion of the working class; (5) a transformative and hegemonic developmental goals; and (6) use of industrial policy. These ingredients have long been thought to be necessary conditions for the growth of the East Asian NICs. If indeed each of these characteristics is a necessary but not sufficient condition for producing developmental states, then it is no wonder that they have been so difficult to replicate elsewhere.

However, Malaysia provides a counterpoint to many of these propositions. It achieved remarkable levels of economic growth and structural transformation through state-led development, while reducing inequalities, without an autonomous bureaucracy, with state-business relationships often characterized by patronage and rent-seeking, and without the types of repression utilized against the urban working class seen in South Korea and Taiwan.³⁵ Discussions in Sections 2 and 3 illustrate that debates are far from settled on the specific institutional forms of developmental states and why those institutional forms emerged where and when they did.

One conclusion evident from a closer examination of the development trajectories across East Asia is that developmental states did not necessarily comply with standard criteria for good governance when intervening in the economy to pursue structural transformation and increases in standards of living for the poor. Even the archetypal developmental states of Japan, South Korea, and Taiwan built

³⁴ Rajan and Subramanian (2007) argue that foreign aid reduces the efficiency of investments in the manufacturing sector by adversely affecting governance.

³⁵ Of course, Malaysia has used repression and has limited the ability of urban labor to organize; however, most of the repression has been about curbing potential opposition leaders and not cracking down on labor as a whole.

bureaucratic capacity over time, withstood some degree of rent-seeking, frequently failed to protect property rights, and relied more on trial and error than on relentlessly pursuing a single, long-term development strategy. Section 6 reveals this to be the case for Malaysia as well: the state actively and successfully pursued improvements in agricultural productivity despite uneven bureaucratic capacity and a considerable degree of rent-seeking. This suggests considerably more scope for states—even those with weaker bureaucracies and some degree of rent-seeking—to pursue state-led development than is typically thought.

In line with this thinking, Section 5 focuses on the “fit” between different types of developmental challenges and the specific types of institutional strengths needed to overcome them. This section lays out many of the policy tools used in state-led development—including agricultural, industrial, and social policy—and outlines the different types of policy challenges raised by each. For example, the state can take on several different roles in seeking to improve agricultural productivity, including enacting land reform, supplying agricultural input subsidies, providing agricultural research and extension services, and investing in rural infrastructure. Each of these activities requires overcoming a different type of policy challenge. Enacting land reforms requires the ability of the state to redistribute land rights while withstanding backlash from the landowning elite. But it does not necessarily require the state to handle particularly complex information or to provide incentives encouraging the behaviors of a large number of frontline service providers. By contrast, implementing agricultural extension services does not require the state to redistribute wealth, but does require the ability to manage the large number of actors and transactions involved in frontline service delivery.

I utilize the Malaysian case to illustrate how this focus on the fit between policy challenges and institutional capabilities can help us to understand why Malaysia has been successful at overcoming some policy challenges and not others. For example, it has been particularly successful at improving service delivery over time, a policy challenge that requires the federal government to have a high degree of influence over local bureaucrats. Malaysia has developed this capacity over time by showing a high level of commitment at the very top echelons of government to monitoring delivery outcomes themselves. This commitment is also reflected in the development of linkages with local-level bureaucrats to collect feedback from citizens on local policy implementation. The Malaysian government has also developed a remarkable willingness to adjust policies based on this feedback, using problem solving and trial and error to achieve the desired outcomes and reversing course when necessary.

Malaysia has benefited from these strengths in cases where public investment was in areas where it had the capacity to meet the specific policy challenges. An example is the way in which the impressive ability of the country to monitor outcomes in rural areas made it uniquely suited to successfully implement large-scale rural infrastructure projects, which it did. However, the government has been less adept at addressing policy challenges with a high degree of informational complexity or that require withstanding pressures from the business elite that support the ruling coalition. These weaknesses have made it difficult for Malaysia to upgrade into high-technology manufacturing. The Malaysia case suggests that matching public investments with existing areas of institutional strengths offers a potential way forward for developing countries seeking to use state action to spur development and transformation. Another route to achieving this goal is to improve the capacity of the top tier of government to strongly commit to particular outcomes—rather than to particular policies.

This project arose from a desire to re-evaluate the role that the state can play in the development process, particularly in overcoming market failures and collective action problems that can stymie efforts to pursue structural change, upgrading, and equity. It has indicated that the state indeed played an outsized role in the East Asian miracle, and that there is a need to understand more about the specific types of capabilities that have enabled states in this region to overcome development challenges. The Malaysian case in particular shows that it is not enough to say that good governance matters or that states must possess capable bureaucracies to successfully play a role in development. The Malaysian state has played a large role in leading structural change despite high degrees of rent-seeking and uneven bureaucratic capacities. However, the case also raises several questions that are critical to answer if the lessons of the case are to be carried elsewhere:

- Why was Malaysia more successful in state involvement in promoting agricultural development as compared to industrial development? What lessons can be learned specifically from Malaysia's organizational and political capabilities in the agricultural sector that could be applied to other countries with similar export concentrations in primary commodities?
- Why did Malaysia pursue rural development so vigorously? As the Tracking Development / Development Regimes in Africa have convincingly argued, many states in Southeast Asia poured vast resources into rural development and improving the livelihoods of smallholder farmers (see Booth et al. 2015). However, it remains unclear why they pursued this development strategy; it is especially unclear in the case of Malaysia, which faced no rural communist threat and began pursuing rural development even before the 1969 riots.³⁶
- Why was the service delivery unit model not successful when adopted in neighboring Indonesia, where it was abandoned in 2014, despite a similar political economy environment? What are the strengths and limitations of the service delivery model, that is, what types of development challenges is this model well suited to address?
- What aspects of Malaysia's political and institutional climate enabled problem solving? In particular, why was the country able to abandon unsuccessful approaches and policies, when this has proved to be so difficult in other contexts?
- What has been the role of foreign aid and natural resource revenues in the emergence of developmental states, including Malaysia? What does this function suggest about potential roles for external actors in fostering developmental states?

³⁶ The Tracking Development / Development Regimes in Africa project argues that states in Southeast Asia pursued rural development, while states in Sub-Saharan Africa did not, because of the biographies of their leaders (for example, Henley 2013). However, this explanation is unsatisfying, particularly for Malaysia, which was ruled at the time by a broad coalition of political parties rather than a single leader.

APPENDIX: ADDITIONAL BACKGROUND ON DEVELOPMENT OUTCOMES ACROSS EAST ASIA

Economic Growth

Table A.1 Economic growth across East Asia

Country	Per capita income, 1960 ^a (% growth, 1960–2014)	Average % growth, 1960–1969	Average % growth, 1970–1979	Average % growth, 1980–1989	Average % growth, 1990–1999	Average % growth, 2000–2009
Japan	\$7,079 (3.20)	9.11	2.92	3.74	1.18	0.44
<i><u>NICs</u></i>						
South Korea	\$1,106 (5.98)	5.50	8.62	7.30	5.68	4.11
Taiwan ^b	\$846 (5.95)	6.33	11.89	9.94	4.02	-0.00
Hong Kong	\$4,721 ^c (4.21)	2.69	6.39	5.90	2.09	3.65
Singapore	\$2,530 (5.24)	6.29	7.79	5.56	4.13	2.90
<i><u>ASEAN-4</u></i>						
Malaysia	\$986 (3.85)	3.45	5.19	3.05	4.52	2.82
Indonesia	\$289 (3.57)	0.99	5.12	4.14	3.19	3.71
Thailand	\$381 (4.39)	4.65	4.76	5.34	4.11	3.57
Philippines	\$696 (1.67)	1.83	2.85	-0.70	0.38	2.56
<i><u>Late-onset, high-performing economies</u></i>						
China	\$121 (6.87)	1.24	5.36	8.20	8.77	9.63
Vietnam	--	--	--	2.14	5.63	5.41
Cambodia	--	--	--	-10.08 ^b	4.16	6.50
Laos	--	--	--	1.22	3.74	5.18
<i><u>Other East Asia</u></i>						
Myanmar	\$387 ^d (--)	0.66	1.91	-0.15	4.75	--
Mongolia	--	-0.20 ^b	-2.13 ^b	3.23	-1.34	4.79
Timor-Leste	--	--	--	--	--	4.21
North Korea	--	--	-1.06 ^b	-1.55 ^b	-2.16 ^b	-1.13 ^b
Brunei	--	--	7.97	-5.19	-0.54	-0.38
<i><u>Regional averages</u></i>						
East Asia	\$1,740 (3.69)	3.55	4.83	2.48	3.08	3.36
LatAm	\$3,315 (1.83)	2.65	3.57	-1.07	1.08	1.75
SSA	\$976 (0.84)	1.74	1.59	-1.41	-0.78	2.69
MENA	\$3,217 ^e (1.91)	--	4.57	-2.10	2.04	2.74

Source: World Development Indicators (World Bank 2015); Penn World Tables 9.0 (Feenstra et al. 2015).

Note: ^a All data in 2005 USD. ^b Data from Penn World Tables 9.0. ^c Data from 1965. ^d Data from Penn World Tables 9.0 from 1962. ^e Data from 1968. ASEAN-4 = Association of Southeast Asian Nations; LatAM = Latin America; MENA = Middle East and North Africa; NIC = new industrializing countries; SSA = Africa south of the Sahara.

Upgrading

Table A.2 Upgrading across East Asia

Country	Manufacturing (% of exports), 2015 (% change 1995–2015)	Resource-based and low tech. manufactures (% of manufactured exports), 2015	Medium-tech. manufactures (% of manufactured exports), 2015	High-tech. manufactures (% of manufactured exports), 2015
Japan	90.9 (-5.9)	19.4	59.3	21.3
<i><u>NICs</u></i>				
South Korea	97.4 (2.3)	22.9	44.7	32.4
Taiwan	94.4 (0.1)	26.0	28.3	45.6
Hong Kong	86.1 (-10.2)	20.6	16.5	62.8
Singapore	90.8 (-2.3)	28.6	24.1	47.3
<i><u>ASEAN-4</u></i>				
Malaysia	83.8 (-4.4)	37.4	21.3	41.3
Indonesia	66.3 (3.8)	67.0	24.1	8.9
Thailand	87.3 (6.7)	37.2	40.5	22.3
Philippines	93.6 (83.1)	24.0	19.5	56.5
<i><u>Late-onset, high-performing economies</u></i>				
China	96.9 (8.6)	40.7	25.5	33.8
Vietnam	81.1 (64.1)	54.5	12.2	33.3
Cambodia	88.6 (12.3)	91.3	5.3	3.3
Laos	53.3 (-36.0)	95.0	4.2	0.8
<i><u>Other East Asia</u></i>				
Myanmar	38.4 (-30.2)	97.0	2.5	0.6
Mongolia	54.8 (-18.5)	97.9	1.3	0.8
Timor-Leste	1.8 (-----)	54.9	31.1	14.0
North Korea	50.2 (-32.2)	74.2	19.2	5.6
Brunei	5.8 (-47.7)	23.7	63.2	13.1
<i><u>Regional totals</u></i>				
East Asia	92.5 (0.1)	33.8	30.5	35.7
LatAm	66.2 (0.0)	40.9	41.5	17.6
SSA	36.1 (-20.9)	66.1	28.6	5.3
MENA	49.2 (28.3)	56.0	35.1	8.9

Source: United Nations Statistics Division (2015).

Note: Using Lall's classifications for resource-based, low-, medium, and high-technology manufacturing. ASEAN-4 = Association of Southeast Asian Nations; LatAM = Latin America; MENA = Middle East and North Africa; NIC = new industrializing countries; SSA = Africa south of the Sahara.

Structural Transformation

McMillan, Rodrik, and Verduzco-Gallo (2014) provide another way to think about the differences in the contributions of sectoral diversification and productivity enhancements to overall growth. They explore the extent to which overall labor productivity growth in the economy is driven by the movement of labor across sectors versus growth within economic sectors. They express the overall labor productivity in the economy as the sum of two components:

$$\Delta Y_t = \sum_{i=n} \theta_{i,t-k} \Delta y_{i,t} + \sum_{i=n} y_{i,t} \Delta \theta_{i,t}$$

where Y_t and $y_{i,t}$ refer to the economywide and the sectoral productivity levels, respectively, and $\theta_{i,t}$ is the share of labor employed in sector i . Δ indicates the change between times $t-k$ and t . Thus, the first term is the sum of the productivity growth within each sector weighted by the initial share of labor employed in the sector. The second term is the sum of change in the share of labor employed in each sector weighted by the productivity levels within the sector at the end of the time period. While the first term captures the contribution of within-sector productivity growth to overall growth, the second term captures the contribution of the reallocation of labor within the economy to overall growth, the “structural change” component.

Using this framework, McMillan, Rodrik, and Verduzco-Gallo (2014) conclude that one of the differentiating features of Asian growth, as compared to growth in Latin America and Sub-Saharan Africa, is the positive contribution of structural change to Asian growth. Whereas in Latin America and Sub-Saharan Africa enhancements in manufacturing productivity often coincided with labor reallocation to less productive sectors (for example, to the informal sector), the opposite was generally the case in East Asia.

However, there is in fact significant variation in the contribution of structural change to economic growth across East Asia. Figure 2.2 utilizes data on sectoral value-add in the economy and sectoral employment from Timmer, de Vries, and de Vries (2015) to calculate the contributions of within-sector productivity growth and across-sector labor reallocation to overall growth. In South Korea and Taiwan, structural change makes an important initial contribution to growth during the early growth period; this is subsequently subsumed by the effects of within-sector productivity enhancements, consistent with the notion that these countries are upgrading into the production of higher value-add products. Data for Malaysia is missing for the 1960s and 1970s, so it is difficult to assess whether it similarly experienced growth-enhancing structural change followed by growth dominated by productivity enhancements. Indonesia and Thailand, by contrast, more closely fit with McMillan, Rodrik, and Verduzco-Gallo’s (2014) description of Asian growth, with significant structural change components and more modest contributions of productivity enhancements, consistent with the relatively lower rates of upgrading into higher value-add exports (Table 2.2). China, meanwhile, has seen large contributions of both structural change and within-sector productivity growth to overall growth.

Figure A.1 Contributions of within-sector productivity growth vs. across-sector labor reallocation to overall growth across East Asia?

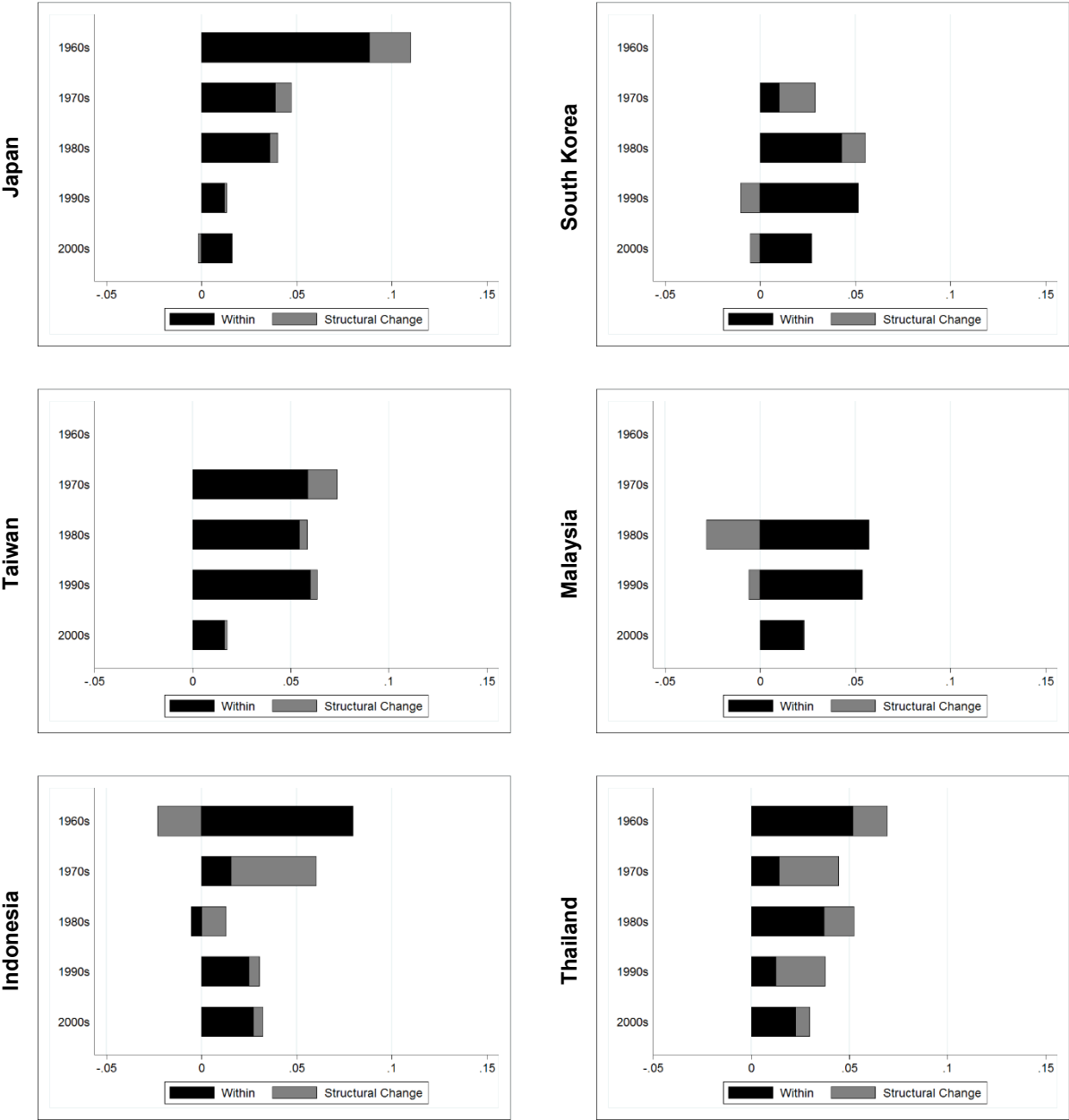
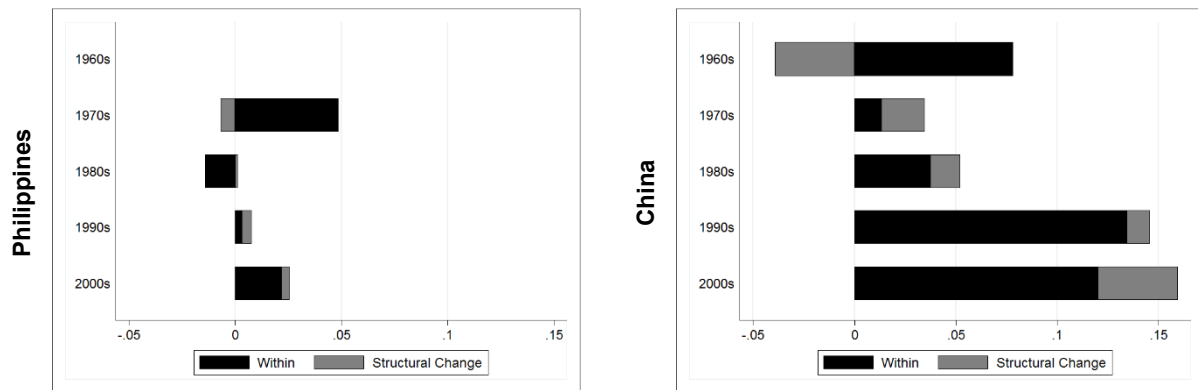


Figure A.1 Continued



Source: Author's calculations using data from Timmer, de Vries, and de Vries (2015).

Capability Enhancement

Table A.3 Capability enhancement across East Asia

Country	Life expectancy at birth (years), 1965	Life expectancy at birth (years), 2014	Mean yrs. of schooling (adults), 1980	Mean yrs. of schooling (adults), 2014	Freedom House Index, Rated "Free" (%years, 1972–2014)
Japan	70.2	83.6	8.7	11.5	100
<i><u>NICs</u></i>					
South Korea	56.8	82.2	7.3	11.9	61.9
Taiwan	--	--	--	--	42.9
Hong Kong	69.6	83.9	6.7	11.2	--
Singapore	67.1	82.6	--	10.6	0.0
<i><u>ASEAN-4</u></i>					
Malaysia	62.2	74.7	4.0	10.0	4.8
Indonesia	51.7	68.9	3.1	7.6	19.0
Thailand	57.1	74.4	3.7	7.3	23.8
Philippines	59.3	68.3	5.4	8.9	28.6
<i><u>Late-onset, high-performing economies</u></i>					
China	49.1	75.8	3.9	7.5	0.0
Vietnam	62.0	75.6	4.2	7.5	0.0
Cambodia	42.1	68.2	--	4.4	0.0
Laos	44.7	66.1	2.1	5.0	0.0
<i><u>Other East Asia</u></i>					
Myanmar	47.0	65.9	1.7	4.1	0.0
Mongolia	52.4	69.5	5.8	9.3	54.8
Timor-Leste	36.3	68.3	--	4.4	0.0
North Korea	54.0	70.1	--	--	0.0
Brunei	65.0	78.8	--	8.8	0.0

Source: World Development Indicators (World Bank 2015); Freedom House Index (Freedom House 2014); Human Development Index (United Nations 2015).

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