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## IN SEARCH OF

# THE 21ST CENTURY DEVELOPMENTAL STATE 1

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## Abstract

What role for the developmental state in the 21<sup>st</sup> century? What state structures and political institutions will best equip nations trying to enter the ranks of "developed" countries? I offer two interconnected propositions. The first stresses continuity: the "developmental state" will continue to play a crucial a role in economic growth and social transformation in the 21<sup>st</sup> century, just as it did in the latter half of the 20<sup>th</sup> century. The second is more radical: successful 21<sup>st</sup> century developmental state will have to depart fundamentally from existing models of the developmental state in order to achieve success. Growth strategies focused primaril

Understandings of the role of the developmental state have changed, first of all, because development theory has changed. In addition, the historical context of development has changed. New challenges, seen through the lens of new theories, point toward a 21<sup>st</sup> century developmental state quite different from its 20<sup>th</sup> century predecessor.

I begin this paper by reviewing the new streams of thinking that currently dominate development theory, starting with the "new growth theory" as put forward by theorists like Lucas (1988) and Romer (1986; 1990; 1993a; 1993b; 1994) and developed by a range of economists like Aghion (Aghion and Howitt 1998) and Helpman (2004). "Institutional approaches" to development, as elaborated by a wide-ranging set of development economists, including Rodrik (1999; Rodrik, Subramanian, and Trebbi 2004), Stiglitz (Hoff and Stiglitz 2001), Acemoglu and Robinson (2005; 2006) among others, are equally important. Perhaps most important of all are the convergences between these theories of growth and the "capability approach" to development as pioneered theoretically by Amartya Sen (1981; 1995; 1999a; 1999b; 2001), and at a more practical level by Mahbub UI Haq (1995).<sup>2</sup>

I will then review the models of the 20<sup>th</sup> century developmental state that were build around the studies of the archetypal cases of Korea and Taiwan by Amsden (1989), Wade (1990) and many others, including myself (e.g., Evans 1992; Evans 1995). The success of these developmental states still remains incontestable, whether the indicator is the Human Development Index (HDI), growth of GDP per capita, or more specific measures of industrial competitiveness. Following the perspective that I laid out a dozen years ago in *Embedded Autonomy* (Evans 1995),Hum5e394.2803 Tm0 1 TcqWMf793 Tm(th)TjET47deEmbDC B small minority this means highly rewarded "business services." For most it means poorly-rewarded personal services.

The confluence of endogenous growth theory with institutional approaches to development and the capability approach jibe nicely with the shifting historical context. Together they suggest that 21<sup>st</sup> century development will depend on generating intangible assets (ideas, skills, and networks) rather than on stimulating investment in machinery and physical assets oriented to the production of tangible goods. This makes investment in human capabilities (which include what is traditionally known as "human capital") more economically critical. At the same time, new development theories assume that economic growth depends on political institutions and the capacity to set collective goals. The capability approach sets out the political argument most firmly, arguing that only public interchange and open deliberation can effectively define development goals and elaborate the means for attaining them.

All of this has powerful implications for the institutional character of the developmental state, which I will develop in the final substantive section. Expanding investment in human capabilities depends above all on public investment. Allocating this investment efficiently requires much broader capacity to collect information. Implementation requires "co-production" of services by communities, families and individuals.<sup>4</sup>

1990).<sup>11</sup> The East Asian Tigers (including the "city state tigers" of Hong Kong and Singapore) managed to change their position in the world economic hierarchy, moving from "underdeveloped" to "developed" in the course of two generations. This kind of shift is not only unprecedented among 20<sup>th</sup> century developing countries, but exceptional even in a broader context that includes the historical experience of Europe and the Americas.

To focus on the East Asian developmental states is to focus on the importance of the capacity of public bureaucracies. Nearly everyone agrees that when East Asian public bureaucracies are comp0.1x(w)2(,4(lewe0.0 of t)veloping countr)-i is 6( puov)]ts

The conventional model of the 20<sup>th</sup> Century developmental state does not, however, appear to fit with either an emphasis on investment in capability-expanding services, as implied by the capability approach, or opening access to intangible assets, as implied by the "new growth theory." The new emphasis on collective goal-setting, so central to both Sen and to institutionalists like Rodrik, is particularly alien to conventional descriptions of state-society relations under the 20<sup>th</sup> century developmental state. Squaring the conventional institutional model of the 20<sup>th</sup> century with the demands of growth and welfare enhancement as seen through the lens of new development theory becomes even more difficult when recent shifts in the historical context of development are added to the equation.

### A Historical Shift in the Character of Development

Development in the current century will differ from the 20<sup>th</sup> century version along a wide variety of dimensions. Looking at the changing sector dynamics is a way of highlighting the differences. Focusing on the declining centrality of manufacturing and the increasingly strategic role of services provides an empirical bridge between changes in development theory and the transformation of the role of the developmental state.

In the conventional 20<sup>th</sup> Century narrative of how development occurred in the rich countries of the North, machine-production plays a starring role. In a very simplified (and slightly caricatured) form, the story runs something as follows: a massive shift of employment from agriculture to manufacturing takes workers out of a sector characterized by declining marginal returns and into one in which learning by doing, spillover effects, and greater possibilities for technological progress enable long term secular increases in labor productivity.

At the same time, machine-production lends itself to political organization, both because workers are socially concentrated and because they are in a position to hold hostage the machines on which profits depend. This coupled with the fact that industrial capitalists have the option of increasing their profits by investing in increased productivity, creates an opening for progressive change. Political organization in the form of unions and associated political parties enables a substantial part of the workforce to capture a share of the productivity gains generated by machine-production and enjoy relatively broad increases in incomes.

In sum, machine-production is posited as creating the possibility of broad-based expansion of incomes by means of two simple, plausible propositions: 1) if you can move a substantial people out of agriculture into manufacturing, and continually give them better machines to work with, their productivity will increase. 2) Marx was correct in suggesting that machine-assisted production facilitated political organization, leading to at least partially successful demands for a more equitable share of this increased productivity.

Looking at the evolution of 20<sup>th</sup> century manufacturing economies in the North, it was not implausible to posit a connection between industrialization and general increases in well-being. By the end of World War II, a combination of rising productivity and political struggle had produced, in the rich, industrialized countries, a "Golden Age of Capitalism" which allowed a relatively large blue collar working class to share in many of the amenities of middle class life. If the 21<sup>st</sup> century appeared likely to sustain this paradigm in the North and extend it to the Global South, projecting the role of the 21<sup>st</sup> Century Developmental state would be much simpler. Unfortunately, neither theoretical analysis nor empirical evidence supports such a positive scenario.

By the late 20th century, manufacturing was going the way of agriculture in the rich countries of the North – a source of employment for an ever shrinking minority of the working population. In the Global South, even impressive increases in manufacturing output proved incapable of generating a blue-collar class of a size and prosperity sufficient to anchor general increases in well-being (see Amsden 2001).

Images, popular in the North, that the Global South is vastly expanding its manufacturing employment (at the presumed expense of Northern workers) are belied by the actual numbers. As Ghosh (2003) points out, in most countries of the Global South globalization has destroyed more local manufacturing jobs than it has created. Carlson (2003) notes that between 1995 and 2002 manufacturing payrolls dropped globally by 22 million. A quick look at trends in a couple of the world's star export manufacturers should suffice to drive this point home.

Korea, a small country in which manufactured exports could be expected to exercise more weight than in larger developing countries, will serve to illustrate the point. In the original "workshop of the world" – Britain – manufacturing provided employment for a third or more of the workforce for almost a century (from 1840 to 1940). In Korea, manufacturing briefly managed to employ about a quarter of the workforce in the early 1990's but immediately fell back below that level. By the end of the 1990's, almost 2 out of 3 Koreans were working in the service sector and manufacturing employment was headed down toward the level of agriculture employment.

China is an even more telling case. Looking at the actual evolution of employment structures in China suggests that the socio-political implications of being the most dynamic manufacturing power of the 21<sup>st</sup> century are quite different than they were in the 19<sup>th</sup> century and early 20<sup>th</sup> century. Employment in Chinese manufacturing peaks at about one worker in seven in the mid-1990s and has already begun to decline at the end of the decade. An independent analysis by economists at Alliance Capital Management found that between 1995 and 2002, China lost on net 15 million manufacturing jobs (Carlson 2003).

The field observations of researchers like William Hurst (2004) and C.K. Lee (2007) give us a sense of the dynamics that underlie these statistical changes. The relatively more

labor absorbing state-owned manufacturing firms of the Northeast are replaced as the dominant form of industrialization by the much more technologically advanced and relatively labor-saving joint-ventures and foreign-owned firms of the Southeast. The result is increasing output but falling employment in manufacturing.

Other successful manufactured exporters in the Global South confirm this general picture. In Brazil, for example, manufacturing's share of peaked by accounting for 1 in 5 jobs in 1980's and began to decline at the end of the 1990's, while service jobs came to account for the majority of employment. In South Africa the story is the same. Manufacturing peaks at about 1 job in 6 at the end of the 1990's and services become the source of protection of monopoly property rights. Consequently, for the most powerful economic actors in a bit-based economy, the key role of the state is maximal enforcement of their monopoly rights to returns from their intangible assets.

When the ideas in question are "producer goods," such as computer software or the chemical formulas involved in the production of medications, enforcing monopoly rights is likely to have anti-developmental effects, quite different from effects of the exclusive ownership of physical capital. Ownership of physical assets only reduces their productivity if the owner uses them inefficiently. Ideas are different. Use of steam engines is a zero sum proposition – if others use my steam engine I can't use it at the same time. As long as I use my steam engine productively, my rights aren't a drag on development. Ideas are non-rival goods – an indefinite number of people can use them at the same time. When monopolists exclude others from using their ideas they rob society of potentially production, diminish the possibility that other users will find innovative new uses for the ideas and slow the overall rate of growth.<sup>15</sup>

There are negative distributional implications as well. The political protection of monopoly rights to productive ideas restricts people's access to the key tools, diminishes their ability to make use of their own "human capital," reduces the number of actors who can participate in the overall process of innovation. Without politically imposed ybvcideas th37sets in thus6(e)5( odeasd(r)-2acts)-6enghiicallynclngid

Taking into account bit-driven growth and the increasing focus of profits on intangible assets and financial assets helps illuminate the consequences of the service sector's dominance as the source of modern employme

resulting talents in the way that will deliver specific returns to the particular investor. In short, private investors will and under invest in "human capital" because they cannot fully control the human being in whom it is embodied. Therefore, markets will chronically fail to supply optimal levels of the "human capital" crucial to bit-driven

cannot escape in any case. The question is whether they undertake it in the aggressive developmental fashion warranted by its central economic importance. Since the underremuneration of capability-expanding services is also a distortion that reduces the wellbeing of a growing portion of the workforce, aggressive action in this arena is a growth strategy with immediate positive welfare effects.

None of this implies tossing aside the institutional achievements of the 20<sup>th</sup> century developmental state. Instead, reflecting on 20<sup>th</sup> century development states in the light of 21<sup>st</sup> century challenges, suggests that traditional emphasis on industrial production neglected some key features of these state's contribution. Without denying the importance of their ability to promote industrial prowess, it is clear in retrospect that 20<sup>th</sup> century developmental states were also pioneers in capability expansion. The East Asian tigers were renowned for their levels of investment in human capital. They began their periods of accelerated economic growth with education levels that made them outliers for countries at their income levels and continued to invest in the expansion of education throughout the period of their rapid expansion. In this optic, late 20<sup>th</sup> century China, which also invested heavily in human capability expansion, looks more like a developmental state. Its investments in health and education, which were exceptionally broad-based, laid the foundations of its subsequent ability to exploit industrial opportunities.

20<sup>th</sup> Century developmental states are also interesting cases with regard to accelerating the production of ideas and expanding access to the existing stock of ideas. "Industrial policy" in both Taiwan and Korea was never restricted to subsidizing investments in plant and equipment. It always focused on increasing the access of local firms to productive ideas and creating networks and incentives to push entrepreneurs towards a greater emphasis on the production of new knowledge. In addition to finding ways to transplant and exploit the stock of knowledge that was ostensibly the property of Northern corporations, the East Asian Tigers, like China, resisted the overprotection of ideas monopolized by Northern corporations, leading to cries of "piracy" from the North, but expanding the access of their citizens to productive ideas.

Finally, these states had another capacity critical to capability expansion. They were able to extract revenues from their own private elites at a level sufficient to maintain the integrity of their own apparatuses and finance necessary investments in capabilityto collect adequate revenue was the pre-requisite to investing in both capabilityexpansion and industrial transformation.

None of this makes 20<sup>th</sup> century developmental states 21<sup>st</sup> century models in disguise. Nor should it lead us to expect that 20<sup>th</sup> century success will continue smoothly into 21<sup>st</sup> century without traumatic institutional transformation. Capable and coherent 20<sup>th</sup> century public bureaucratic apparatuses are an invaluable foundation for the additional capacities that need to be constructed to meet 21<sup>st</sup> century challenges, but they are not sufficient.

More problematically, 20<sup>th</sup> century success has shifted the balance between public and private power in ways that could undermine future institutional transformation. Developmental success has strengthened private capital and increased the domestic political role of transnational capital. Deeply established reliance on local private economic elites, the growing centrality of transnational capital to local accumulation and the proliferation of alliances between local and transnational capital have transformed the political landscape into something quite different than it was 40 years ago.

The shifting balance of public and private power runs directly counter to the requirements of 21<sup>st</sup> century strategies, which demands a stronger more capable public sector than the 20<sup>th</sup> Century version. In the 20<sup>th</sup> century manufacturing-focused development project, the symbiosis between private profitability and a shared national project was easier to execute. Shared projects around industrialization depended on counterbalancing private risk aversion and pushing private perspectives toward a longer time horizon, but the eventual productive capacity fit nicely into a profitability-focused market logic. Capability-expansion fits less easily into a shared project with private capital. When capability-expansion is the goal, risk abatement and horizon extension are unlikely to compensate for the persistent gap between social and private returns. Precisely because of the large "collective goods" element in capability-expansion, productive alliances with private capital are less easily constructed. State-society ties remain, nonetheless, critically important.

In the 20<sup>th</sup> century model of the developmental state, embeddedness was important both as a source of information and because implementation of shared projects depended on private actors. In the 21<sup>st</sup> century version the same dynamics hold but the interlocutors and the character of the networks are both different. Efficient allocation of capabilityexpanding investment requires a much broader set of information than that required for the allocation of investments in plant and equipment.

In the case of industrial investment, the key information involved figuring out which projects were feasible, how much this feasibility depended upon overcoming "collective action problems" among firms. The same kind of information is required in the case of capability expansion, but it must be gathered from constituencies that are more numerous and less organized. In addition, the value of a project cannot be assessed on the basis of a

simple technocratic measure, such as rate of return on investment or projected market share. Whether a project is worthwhile depends, in large measure on how well its results correspond to the collective preferences of the communities being served.

The skills and organization required to aggregate and assess this kind of information demand qualitatively more capable state apparatus. Nonetheless, accurate information on collective priorities at the community level is the *sine qua non* of a successful 21<sup>st</sup> century developmental state. Without multiple channels getting accurate information, the developmental state will end up investing inefficiently and wasting precious public resources.

Engaging societal actors in implementation is as crucial to capability-expanding strategies as getting information on goals from them. As Ostrom (1996) has emphasized, capability enhancing services are always co-produced by their "recipients." Education is co-produced by students (and their families). Health is co-produced by patients, their families and their communities. The state needs their active engagement in the delivery of those services in order to insure that the investments produce the desired effects. Delivery to passive recipients produces results that are sub-optimal at best and sometimes counter-productive. Once again, the skills and organizational capacities required to stimulate this kind of engagement are more complex and harder to construct because they are more political than technocratic.

In order to be able to create effective state-society linkages, the state must facilitate the organization of counterparts in "civil society." The 20<sup>th</sup> century development state's interaction with industry gave industrial elites a reason to become a more collectively coherent class. The 21<sup>st</sup> Century developmental state must do the same for a much broader cross-section of society. It won't be easy. "Civil society" is a complicated beast, full of conflicting particular interests and rife with individuals and organizations claiming to represent the general interest. Still, shared interests in capability expansion are broad and deep. In addition, since capture is less of a danger in building ties with non-elites, the public institutions can concentrate on the positive side of this political project.

Returning to the political dimension of state capacity brings us back to institutional and capability approaches to development. Institutional approaches have increasingly emphasized the political dimensions of the institutions that support growth. An archetypal example is Rodrik's (1999: 19) argument that it may be "helpful to think of participatory political institutions as meta-institutions that elicit and aggregate local knowledge and thereby help build better institutions." For Rodrik, developing institutions that allow effective social choice is central to enabling societies to develop the capacity to "build better institutions" of other kinds.

Political institutions are even more foundational in the capability approach. Sen argues democratic deliberation is the only way of adequately defining what the desired economic ends might be. In addition, since the capability of making choices is one of the most important of all human capabilities, "processes of participation have to be

understood as constitutive parts of the *ends* of development in themselves' (Sen 1999a: 291).

The centrality of dense connections to civil society and the construction of democratically deliberative institutions would at first seem to make the 21<sup>st</sup> century developmental state the political antithesis of the 20<sup>th</sup> century version. A closer look suggests that the classic 20<sup>th</sup> century developmental states have already begun to change the character of their embeddedness. For example, Joseph Wong's (2004) analysis of the expansion of health care over the course of the 1980's and 1990's shows Taiwan and Korea managing to shed enough of their authoritarian traditions to allow public deliberation to move policy priorities in the direction of capability-centered development. Failure to reconstruct political institutions expand the scope of state-society ties may still undercut the developmental capacities of 20<sup>th</sup> century developmental states, but their institutional capacity to "reinvent themselves" should not

dynamic economies. They will also better enable their citizens to "lead the kind of lives they value – and have reason to value."

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