

CHAPTER 6

Trade and Development I: Import Substitution Industrialization

Mexico has experienced an economic revolution during the last 20 years. Until the mid-1980s, Mexico was one of the most heavily protected and highly directed nonsocialist economies in the world. Importing anything into the country required formal government approval. Even with such approval, tariffs were very high, averaging over 25 percent and rising as high as 100 percent for many goods. Moreover, Mexico did not belong to the General Agreement on Tariffs and Trade (GATT), and it was hard to imagine any conditions under which Mexico would seek a free-trade agreement with the United States. Behind these high tariff walls, the Mexican government intervened deeply in the domestic economy. Government-owned financial institutions channeled investment capital to favored private industries and projects. The government created state-owned enterprises in many sectors of the economy (about 1,200 of them by 1982) that together attracted more than one-third of all industrial investment (La Porta and López de Silanes 1997). Today, by contrast, Mexico is one of the most open developing countries in the world. Mexico entered the GATT in 1987 and the North American Free Trade Agreement (NAFTA) in the early 1990s. The Mexican government has retreated sharply from involvement in the domestic economy. It has sold state-owned enterprises, liberalized a wide variety of market-restricting regulations, and begun to integrate Mexico deeply into the global economy. In less than 10 years, the Mexican government opened Mexico to foreign competition and drastically scaled back its role in managing Mexican economic activity.

Mexico's experience is hardly unique. Governments in India, China, much of Latin America, and most of sub-Saharan Africa opted out of the

global trade system following World War II. Most governments erected very high trade barriers, and to the extent that they participated at all in the GATT, they sought to alter the rules governing international trade. Convinced that the GATT was biased against their interests, developing countries worked through the United Nations to create international trade rules that they believed would be more favorable toward industrialization in the developing world. Like Mexico, most governments intervened extensively in their economies in an attempt to promote rapid industrialization. Drawing on the logic of the infant-industry case for protection, governments used the power of the state to pull resources out of agriculture and push them into manufacturing. And, like Mexico, these policy orientations have changed fundamentally since the late 1980s. Most developing countries have dismantled the protectionist systems they maintained in the first 30 years of the postwar period, have become active participants in the World Trade Organization (WTO), and have abandoned the quest to institute far-reaching changes to international trade rules. Most have greatly reduced the degree of government intervention in the domestic economy.

This chapter and the next examine how political and economic forces have shaped the adoption and evolution of these new trade and development policies. This chapter examines why governments in so many developing countries intervened deeply in their domestic economies, insulated themselves from international trade, and sought changes in international trade rules. The next chapter focuses on why so many governments have dismantled these policies during the last 30 years. We look first at how economic and political change throughout the developing world brought to power governments supported by import-competing interests. We then examine the economic theory that guided policy during those times. As we shall see, this theory provided governments with a compelling justification for transforming the protectionism sought by the import-competing producers that supported them into policies that emphasized industrialization through state leadership. Having built this base, we turn our attention to the specific policies that governments pursued during that period, looking first at their domestic strategy for industrialization and then examining their efforts to reform the international trade system.

DOMESTIC INTERESTS, INTERNATIONAL PRESSURES, AND PROTECTIONIST

COALITIONS

Developing countries' trade policies underwent a sea change in the first half of the twentieth century. Until World War I, those developing countries that were independent, as well as those regions of the world held in colonial empires, adopted liberal trade policies. They produced and exported agricultural goods and other primary commodities to the advanced industrialized countries and imported most of the manufactured goods they consumed. Governments and colonial rulers made little effort to restrict this trade. But by the late 1950s, these liberal trade policies had been replaced by a protectionist approach that dominated the developing countries' trade policies until the late 1980s, and whose remnants remain important in many countries today. We begin our investigation of developing countries' trade and development policies by looking at this initial shift to protectionism.

Trade and development policies in developing countries have been strongly shaped by political competition between rural-based agriculture and urban-based manufacturing. Developing countries pursued liberal trade policies prior to World War I because export-oriented agricultural interests dominated politics. In general, developing countries are abundantly endowed with land and poorly endowed with capital (Lal and Myint 1996, 104–110).

The relative importance of land and capital in developing countries' economies can be appreciated by examining the structure of those economies, together with exports, as presented in [Table 6.1](#) and [Table 6.2](#). For the time being, we will focus on 1960, as this will allow us to put to the side the consequences of the development policies that governments adopted during the postwar period. With a few exceptions (particularly in Latin America), between one-third and one-half of all economic activity in developing countries in 1960 was based in agriculture, whereas less than 15 percent was based in manufacturing. By contrast, agriculture accounted for only 5 percent of gross domestic product (GDP) in the advanced industrial economies. If we include the “other industry” category, which incorporates mining, then in all regions of the developing world other than Latin America, agriculture and nonmanufacturing industries accounted for more than half of all economic activity.

A similar pattern is evident in the commodity composition of developing countries' exports ([Table 6.2](#)). In 1962, developing countries' exports were heavily concentrated in primary commodities: agricultural products, minerals, and other raw materials. Roughly speaking, in each

developing country, primary commodities accounted for more than 50 percent of exports, and in more than half of the listed countries, primary commodities accounted for more than 80 percent of exports. In addition, each country exported a narrow range of primary commodities. Some countries were **monoexporters**; that is, their exports were almost fully accounted for by one product. For example, more than 80 percent of Burundi's export earnings came from coffee, and cocoa accounted for 75 percent of Ghana's export earnings (Cypher and Dietz 1997, 339). Similar patterns were evident in Latin America: in 1950, coffee and cocoa made up about 69 percent of Brazil's exports, and copper and nitrates constituted about 74 percent of Chile's exports (Thorp 1999, 346). The structure of their economies and the composition of their exports thus underline the central point: developing countries are abundantly endowed with land and have little capital.

TABLE 6.1

Economic Structure in Developing Countries (Sector as a Percent of Gross Domestic Product)

	Agriculture			Manufacturing			Other Industry			Services		
	1960	1980	1995	1960	1980	1995	1960	1980	1995	1960	1980	1995
Sub-Saharan Africa	36	24	20	12	12	15	18	24	15	40	38	48
East Asia and the Pacific	46	27	18	16	27	32	7	12	12	31	32	38
South Asia	49	39	30	13	15	17	6	9	10	33	35	41
Latin America	16	10	10	21	25	21	10	12	12	53	51	55

Notes: Figures may not sum to 100 because of rounding.

Other Industry Includes mining, construction, gas, and water.

Sources: Data for 1960 from World Bank, *World Tables*, 3rd ed. (Washington, DC: The World Bank, 1983). Data for 1980 and 1995 from World Bank, *World Development Indicators* (Washington, DC: The World Bank, 1997).

TABLE 6.2

Developing Countries' Export Composition (Sector as a

Percent of Total Exports)

	Fuels, Minerals, and Metals			Other Primary Commodities			Manufactures		
	1962	1980	1993	1962	1980	1993	1962	1980	1993
Sub-Saharan Africa									
Cameroon	21	33	51	75	64	35	4	4	14
Ghana	73	17	25	31	82	52	1	1	23
Kenya	2	36	16	89	52	66	9	13	19
Nigeria	11	97	94	81	2	4	8	0	2
South Africa	23	33	16	47	28	11	26	40	74
Zaire	16	56	69	75	14	13	10	31	18
East Asia and the Pacific									
Hong Kong	2	2	2	3	5	3	93	93	96
Indonesia	37	76	32	63	22	15	0	3	53
Malaysia	n.a.	35	14	n.a.	46	21	n.a.	20	65
Singapore	52	31	14	18	18	6	30	51	80
South Korea	24	1	3	57	9	4	20	90	94
Taiwan	n.a.	2	2	n.a.	10	5	n.a.	88	93
South Asia									
India	9	8	7	47	33	18	44	59	75
Pakistan	0	8	1	75	44	14	25	48	85
Latin America									
Argentina	2	6	11	95	71	57	3	23	32
Bolivia	91	86	56	4	11	25	5	3	19
Brazil	9	11	12	88	50	28	3	39	60
Chile	87	65	43	8	25	38	4	10	19
Mexico	24	73	17	60	15	9	16	12	75

Note: n.a. = not available.

Sources: Data for 1962 from World Bank, *World Tables*, 3rd ed. (Washington, DC: The World Bank, 1983). Data for 1980 and 1993 from World Bank, *World Development Indicators* (Washington, DC: The World Bank, 1997).

The precise form through which landowners dominated politics prior to World War II differed considerably across regions. In Latin America, an indigenous landowning elite dominated domestic politics. In Argentina and Chile, for example, the landowners controlled government, often in an alliance with the military. Even though these political systems were constitutionally democratic, participation was restricted to the elite, a group that amounted to about 5 percent of the population, in a system that has been characterized as “oligarchic democracy” (Skidmore and Smith

1989, 47). In other Latin American countries such as Mexico, Venezuela, and Peru, dictatorial and often military governments ruled, but they pursued policies that protected the interests of the landowners (Skidmore and Smith 1989, 47). With landowners dominating domestic politics, Latin American governments pursued liberal trade policies that favored agricultural production and export at the expense of manufactured goods (Rogowski 1989, 47). As a result, most Latin American countries were highly open to international trade, producing and exporting agricultural goods and other primary commodities and importing manufactured goods from Great Britain, Europe, and the United States.

In Asia and in Africa, export-oriented agricultural interests dominated local politics through colonial structures. In Taiwan and Korea, for example, Japanese colonization led to the development of **enclave agriculture**—that is, export-oriented agricultural sectors that had few linkages to other parts of the local economy (Haggard 1990). Agricultural producers bought little from local suppliers and exported most of their production. In both countries, agricultural production centered on the production and export of rice; in Taiwan, sugarcane was a staple crop as well. India produced and exported a range of primary commodities, including cotton, jute, wheat, tea, and rice. In exchange, India imported most of the manufactured goods it consumed from Britain. In Africa, colonial powers encouraged the production of cash crops and raw materials that could be exported to the mother country (Hopkins 1979; Ake 1981, 1996). In the Gold Coast (now Ghana), the cocoa industry was a small part of the economy in 1870. Under British rule, Ghana became the world's largest cocoa producer by 1910, and cocoa accounted for 80 percent of its exports. In Senegal, France promoted groundnut (the American peanut) production, and by 1937 close to half of all cultivated land was dedicated to this single product (Ka and Van de Walle 1994, 296). Similar patterns with other commodities were evident in other African colonies (Hopkins 1979).

These political arrangements began to change in the early twentieth century. As they did, the dominance of export-oriented interests gave way to the interests of import-competing manufacturers. In many instances, the most important triggers for this change originated outside of developing societies. In Latin America, international economic shocks beginning with the First World War and extending into World War II played a central role (Thorp 1999, [Chapter 4](#)). Government-mandated rationing of goods and primary commodities in the United States and Europe during the two World Wars made it difficult for Latin American countries to import many

of the consumer goods they had previously purchased from the industrialized countries. In addition, falling commodity prices associated with the Great Depression and the disruption of normal trade patterns arising from World War II reduced export revenues. The interruption of “normal” Latin American trade patterns led governments in many countries to introduce trade barriers and to begin producing many of the manufactured goods that they had previously imported. The rise of domestic manufacturing in turn produced a growing urban middle class as workers and industrialists began to move out of agricultural production and into manufacturing industries.

The emergence of manufacturing industries gave rise to interest groups, industry-based associations, and labor unions that pressured the government to adopt economic policies favorable to people working in the import-competing sector. The creation of organized groups to represent the interests of import-competing manufacturing generated its own political logic. On the one hand, the groups that saw their incomes rise from protection had a strong incentive to see protectionist policies continued in the postwar period (see Rogowski 1989; Haggard 1990). On the other hand, the emergence of new organized interests and a growing urban middle class created an opportunity for politicians to construct new political coalitions based on the support of the urban sectors. In Argentina, for example, Juan Perón rose to power in the late 1940s with the support of labor, industrialists, and the military. A similar pattern was evident in Brazil, where Getúlio Vargas was elected to the presidency in 1950 with the support of industrialists, government civil servants, and urban labor. Nor were Argentina and Brazil unique: throughout Latin America, postwar governments were much less tightly linked to landed interests than governments had been before World War I. Instead, governments rose to power on the basis of political support from interest groups whose incomes were derived from import-competing manufacturing (Cardoso and Faletto 1979). Such governments had a clear incentive to maintain trade policies that protected those incomes.

A similar dynamic is evident in India. The global economic collapse of the 1930s forced India to become increasingly self-reliant. Markets for Indian exports constricted sharply, thereby greatly constraining Indian export revenues. Unable to earn foreign exchange, India had to reduce imports of manufactured goods as well. Under this forced self-reliance, India began to create an indigenous manufacturing sector. By the end of World War II, India had emerged as “the tenth largest producer of manufactured goods in the world” (Tomlinson 1979, 31). The indigenous

urban manufacturing sector then fused with the burgeoning nationalist movement during the late 1930s to lead the push for Indian independence and to supplant the predominantly foreign-owned export sector at the center of the Indian political system. By the time India achieved independence in 1947, it was committed to a strategy of autonomous industrialization.

In Pacific Asia, the shift in political power came about as a product of de-colonization. In Korea and Taiwan political change resulted from the defeat of Imperial Japan in World War II (see Haggard 1990). In South Korea, Japan's defeat transferred power from a foreign colonizer to indigenous groups. Although the landowners initially dominated postwar politics, the Korean War of the early 1950s and a series of land reforms implemented during that same decade greatly reduced the landowners' power and increased the relative power of the emerging urban sector. On mainland China, Japan's defeat was followed by the defeat of the nationalist Chinese government and the migration of the Chinese nationalists to the island of Taiwan. Once installed in Taiwan, the Chinese nationalists instituted land reforms to assert their authority over indigenous landowners and to prevent a repeat of their experience on the mainland, where the rural sector had supported the Communists. As in South Korea, land reforms reduced the power of landowners and increased the power of the urban-industrial sector.

Africa's transition came later, as decolonization began only in the 1950s, and it took a slightly different form. The push toward decolonization was led by a coalition of indigenous professionals who had been educated by the colonial powers and had then acquired positions in the administration of colonial economic and political rule. One factor motivating Africa's push for independence was dissatisfaction with the discriminatory practices of colonial administration. Colonies were run for the profit of the colonists, with colonial economic enterprises staffed and managed by men from the colonial power. The local population had limited opportunities to participate in these economic arrangements other than as workers. The nationalist struggles for independence that emerged in the 1950s sought to transfer control over existing economic practices from the colonial governments to indigenous elites.

The period demarcated by the start of World War I and the end of decolonization in sub-Saharan Africa thus brought a fundamental change to patterns of political influence in developing countries. Political structures once dominated by export-oriented agricultural interests were now largely under the control of import-competing manufacturing

interests. Consequently, governments beholden to the import-competing sector had a clear incentive to abandon liberal trade policies and to continue the protectionist arrangements they had built during the 1930s. As we will see, the political interest in protectionism was reinforced by an elaborate theoretical structure that argued that protectionism was the only path to the establishment of industrialized economies.

THE STRUCTURALIST CRITIQUE: MARKETS, TRADE, AND ECONOMIC DEVELOPMENT

Although protectionism reflected the interests of the politically influential import-competing manufacturing sector, it did not represent a coherent economic development strategy. And most governments were committed, at least rhetorically, to the adoption of policies that would promote economic development. Most governments wanted to shift resources out of agricultural production and into manufacturing industries because they believed that poverty resulted from too heavy a concentration on agricultural production. Higher standards of living could be achieved only through industrialization, and according to what was then the dominant branch of development economics, called **structuralism**, the shift of resources from agriculture to manufacturing would not occur unless the state adopted policies to bring it about (see Lal 1983; Little 1982).

The belief that the market would not promote industrialization provided the intellectual and theoretical justification for the two central aspects of the development strategies adopted by most governments throughout much of the postwar era. Because structuralism played such an important role in shaping developing countries' trade and development policies, understanding the policies governments adopted requires us to understand the structuralist critique.

Market Imperfections in Developing Countries

Structuralists argued that market imperfections inside developing countries posed serious obstacles to the reallocation of resources from agriculture to manufacturing industries. Structuralists argued that markets would not bring about the necessary shift of resources because developing economies were too inflexible.

Most important, according to the structuralists, was the belief that the market would not promote investment in manufacturing industries (Scitovsky 1954). The structuralists pointed to two coordination problems

that would limit investment in manufacturing industries. The first problem, called **complementary demand**, arose in the initial transformation from an economy based largely on subsistence agriculture to a manufacturing economy (Rosenstein-Rodan 1943). In an economy in which few people earned a money wage, no single manufacturing firm would be able to sell its products unless a large number of other manufacturing industries were started simultaneously. Suppose, for example, that 100 people are taken out of subsistence agriculture and paid a wage to manufacture shoes, whereas the rest of the population remains in non-wage agriculture. To whom will the new factory sell its shoes? The only workers earning money are those producing shoes, and these 100 workers are unlikely to purchase all of the shoes that they make. In order for this shoe factory to succeed, other factories employing other people must be created at the same time.

Suppose instead, that 500,000 workers are taken out of subsistence agriculture and simultaneously employed in a large number of factories producing a variety of different goods; some make shoes, others make clothing, and still others produce refrigerators or processed foods. With this larger number of wage earners, manufacturing enterprises can easily sell their goods. Shoe workers can buy refrigerators and clothes, workers in the clothing factory can purchase shoes, and so on. Thus, a manufacturing enterprise will be successful only if many manufacturing industries began production simultaneously.

Structuralists doubted that uncoordinated market behavior would produce simultaneous investment in multiple manufacturing industries. No single entrepreneur has an incentive to invest in a manufacturing enterprise unless he or she is certain that others will invest simultaneously in other industries. People willing to invest will thus wait until others invest and, as a consequence, no one will invest in manufacturing unless all potential investors could somehow coordinate their behavior to ensure that all will invest in manufacturing at the same time. The problem of complementary demand thus meant that if investment were left to the market, there would be little investment in manufacturing industries.

The second coordination problem, called **pecuniary external economies**, arose from interdependencies among market processes (Scitovsky 1954). Think about the economic relationship between a steel plant and an automobile factory. Suppose that the owners of a steel factory invest to increase the amount of steel they can produce. As steel production increases, steel prices begin to fall. The automobile factory, which uses a lot of steel, begins to realize rising profits as the price of one of its most important inputs falls. These increasing profits in the

automobile industry could induce the owners of the car plant to invest to expand their own production capacity. Such a simultaneous expansion of the steel and auto industries would raise national income.

The two firms face a coordination problem, however. The owners of the steel plant will not increase steel production unless they are sure that the auto industry will increase car production. Yet, the owners of the auto plant will not increase auto production unless they are certain that the steel producer will make the investments needed to expand steel output. Thus, unless investment decisions in the steel and auto industry are coordinated, neither firm will invest to increase the amount it can produce. Once again, structuralists argued, the market could not be expected to solve this coordination problem.

The structuralists' assertion that coordination problems would prevent investment in manufacturing was a serious problem for governments intent on industrialization. Fortunately, the structuralists offered a solution to the problem. Structuralists argued that the way to overcome these coordination problems was with a state-led **big push**. The state would engage in economic planning and either make necessary investments itself or help coordinate the investments of private economic actors. Thus, what the market could not bring about, the state could achieve through intervening in the economy. The structuralist critique of the market therefore provided a compelling theoretical justification for state-led strategies of industrialization.

Market Imperfections in the International Economy

Structuralists also argued that international trade provided few benefits to developing countries. This argument was formulated during the 1950s, principally by Raul Prebisch, an Argentinean economist who worked for the United Nations Economic Commission for Latin America (ECLA), and Hans Singer, an academic development economist. According to the **Singer-Prebisch theory**, participation in the GATT-based trade system would actually make it harder for developing countries to industrialize by depriving them of critical resources.

The Singer-Prebisch theory divides the world into two distinct blocks—the advanced-industrialized core and the developing-world periphery—and focuses on the terms of trade between them. The **terms of trade** relate the price of a country's exports to the price of its imports. An improvement in a country's terms of trade means that the price of its exports is rising relative to the price of its imports, but a decline in a country's terms of

trade means that export prices are falling relative to its import prices. As a country's terms of trade improve, it can acquire a given amount of imports for a smaller quantity of exports. Thus, an improvement in its terms of trade makes a country richer, but a decline in its terms of trade makes it poorer.

The Singer-Prebisch theory argues that developing countries' terms of trade deteriorate steadily over time. When they developed this theory, developing countries exported primary commodities and imported manufactured goods. Singer and Prebisch argued that primary commodity prices steadily fell relative to manufactured goods prices, thereby steadily reducing the incomes of developing countries. The periphery's terms of trade deteriorate, according to this theory, in large part as a result of differences in the income elasticity of demand for primary commodities versus industrial goods (see Lewis 1954; United Nations 1964; Gilpin 1987, 275–276).

The income elasticity of demand is the degree to which a change in income alters demand for a particular product. For a product with a low income elasticity of demand, a large increase in income produces little change in demand for the good. For a product with a high income elasticity of demand, a small increase in income produces a large change in demand for a particular good. Structuralists argued that the income elasticity of demand for primary commodities was quite low, but income elasticity of demand for manufactured goods was relatively high. Thus, as incomes rise in the core countries, a smaller and smaller percentage of those countries' income will be spent on imports of primary commodities. But as incomes rise in the periphery countries, a larger percentage of *those* countries' income will be spent on manufactured imports from the core. Falling demand for primary commodities will cause the periphery countries' export prices to fall, whereas rising demand for manufactured goods will cause the periphery countries' import prices to rise. Rising import prices relative to export prices yields deteriorating terms of trade.

Most research disputes the claim that developing countries face a continuous decline in their terms of trade (see, for example, Borensztein et al. 1994; see also Bloch and Sapsford 2000). Yet, the objective validity of the Singer-Prebisch hypothesis is not the central consideration. What mattered was that governments in developing countries *believed* the hypothesis. Governments of developing countries were convinced that industrialization would not occur if they participated in the GATT-based international trade system. This conviction played an important role in shaping the trade and development policies that developing countries

adopted.

DOMESTIC AND INTERNATIONAL ELEMENTS OF TRADE AND DEVELOPMENT STRATEGIES

Structuralism enabled governments to transform the protectionist trade policies that benefited their principal political supporters into comprehensive state-led development strategies. The trade and development policies that most governments adopted following World War II had both a domestic and an international dimension. At home, the desire to promote rapid industrialization led governments to adopt state-led development strategies that were sheltered by high protectionist barriers. In the international arena, concern about the distributional implications of international trade led developing countries to seek far-reaching changes to the GATT-based trade system. We examine each dimension in turn.

Import Substitution Industrialization

Structuralism provided the intellectual justification for a state-led development strategy. Confidence that the state could achieve what markets would not was based in part on evidence of the dramatic industrialization that the Soviet Union had achieved between 1930 and 1950 with an approach based on centralized planning and state ownership of industry. In developing societies outside the Soviet bloc, this state-centered approach to development came to be called **import substitution industrialization**, or ISI. The strategy of ISI was based on a simple logic: countries would industrialize by substituting domestically produced goods for manufactured items they had previously imported.

Governments conceptualized ISI as a two-stage strategy (see [Table 6.3](#)). Its initial stage was “wholly a matter of imitation and importation of tried and tested procedures” (Hirschman 1968, 7). **Easy ISI**, as this first stage was often called, focused on developing domestic manufacturing of relatively simple consumer goods, such as soda, beer, apparel, shoes, and furniture. The rationale behind the focus on simple consumer goods was threefold. First, there was a large domestic demand currently satisfied by imports. Second, because these items were mature products, the technology and machines necessary to produce them could be acquired easily from the advanced industrialized countries. Third, the production of relatively simple consumer goods relies heavily on low-skilled labor, allowing developing societies to draw their populations into manufacturing

activities without making large investments to upgrade their skills.

Governments expected to realize two broad benefits from easy ISI. Initially, the expansion of manufacturing activities would increase wage-based employment as underutilized labor was drawn out of agriculture and into manufacturing. In addition, the experience gained in these manufacturing industries would allow domestic workers to develop skills, collectively referred to as general human capital, that could be applied subsequently to other manufacturing businesses. Of particular importance were the management and entrepreneurial skills that would be gained by people who worked in and managed the manufacturing enterprises established in this stage. Success in the easy stage would therefore create many of the ingredients necessary to make the transition to the second stage of ISI.

TABLE 6.3

Stages of Industrialization in Mexico and Brazil, 1880–1968

	Commodity Exports, 1880–1930	Primary ISI, 1930–1955	Secondary ISI, 1955–1968
Main Industries	Mexico: Precious metals, minerals, oil Brazil: Coffee, rubber, cocoa, cotton	Mexico and Brazil: Textiles, food, cement, iron and steel, paper, chemicals, machinery	Mexico and Brazil: Automobiles, electrical and nonelectrical machinery, petrochemicals, pharmaceuticals
Major Economic Actors	Mexico: Foreign investors Brazil: National private firms	Mexico and Brazil: National private firms	Mexico and Brazil: State-owned enterprises, transnational corporations, and national private firms
Orientation of the Economy	World market	Domestic market	Domestic market

Note: ISI = import substitution industrialization.

Source: Gereffi 1990, 19.

Easy ISI would eventually cease to bear fruit. The domestic market's capacity to absorb simple consumer goods would be exhausted, and the range of such goods that could be produced would be limited. At some point, therefore, governments would need to shift from easy ISI to a second-stage strategy characterized by the development of more complex manufacturing activities. One possibility would be to shift to what some have called an **export substitution strategy**, in which the labor-intensive manufactured goods industries developed in easy ISI begin to export rather than continue to produce exclusively for the domestic market. Many East Asian governments adopted this approach, as we shall see in [Chapter 7](#).

The second alternative, and the one adopted by most governments outside of East Asia, was **secondary ISI**. In secondary ISI, emphasis shifts from the manufacture of simple consumer goods to consumer durable goods, intermediate inputs, and the capital goods needed to produce consumer durables. In Argentina, Brazil, and Chile, for example, governments decided to promote domestic automobile production as a central component of secondary ISI. Each country imported cars in pieces, called complete knockdowns, and assembled the pieces into a car for sale in the domestic market. Domestic auto firms were required to gradually increase the percentage of locally produced parts used in the cars they assembled. In Chile, for example, 27 percent of a locally produced car's components had to be manufactured domestically in 1964. The percentage rose to 32 percent in 1965 and then to 45 percent in 1966 (Johnson 1967).

By increasing the percentage of local components of cars and other goods in this manner, governments hoped to promote the development of backward linkages throughout the economy (Hirschman 1958). **Backward linkages** arise when the production of one good, such as a car, increases demand in industries that supply components for that good. Thus, increasing the percentage of locally produced components of cars, by increasing the demand for individual car parts, would increase domestic part production. The latter would in turn increase demand for inputs into part production: steel, glass, and rubber, for example. Industrialization, therefore, would spread backwards from final goods to intermediate inputs to capital goods as backward linkages multiplied.

Governments promoted secondary ISI with three policy instruments: government planning, investment policy, and trade barriers. Most governments structured their efforts around 5-year plans (Little 1982, 35). Planning was used to determine which industries would be targeted for

development and which would not, to figure out how much should be invested in a particular industry, and to evaluate how investment in one industry would influence the rest of the economy. India's second Five Year Plan (1957–1962), for example, sought to generate ambitious growth in manufacturing by targeting the development of capital goods production (Srinivasan and Tendulkar 2003, 8). The plan thus served as the coordination device that governments thought necessary, given their belief that the market itself could not coordinate investment decisions.

With a plan in place, governments used investment policies to promote targeted industries. Most governments either nationalized or heavily controlled the financial sector in order to direct financial resources to targeted industries. Governments also invested directly in those economic activities in which they thought the private sector would not invest. Much of the infrastructure necessary for industrialization—things such as roads and other transportation networks, electricity, and telecommunications systems—it was argued, would not be created by the private sector. In addition, the private sector lacked access to the large sums of financial support needed to make huge investments in a steel or auto plant. Moreover, it was claimed that private-sector actors lacked the technical sophistication required for the large-scale industrial activity involved in secondary ISI.

Governments invested in these industries by creating state-owned and mixed-ownership enterprises. In Brazil, for example, state-owned enterprises controlled more than 50 percent of total productive assets in the chemical, telecommunications, electricity, and railways industries and slightly more than one-third of all productive assets in metal fabrication (Trobat 1983). Indian state-owned enterprises provided 27 percent of total employment and 62 percent of all productive capital (Krueger 1993a, 24–5). In Africa, governments in Ghana, Mozambique, Nigeria, and Tanzania each created more than 300 state-owned enterprises, and in many African countries, state-owned enterprises accounted for 20 percent of total wage-based employment (World Bank 1994b, 101). Throughout developing societies, therefore, the shift to secondary ISI was accompanied by the emergence of the state as a principal, and in many instances the largest, owner of productive capacity.

Finally, governments used trade barriers to control foreign exchange and protect infant industries. Because export earnings were limited, governments controlled foreign trade to ensure that foreign exchange supported their development objectives (Bhagwati 1978, 20–33). After all, many elements critical to industrialization, including intermediate inputs

and capital goods, had to be imported. Protection also allowed infant industries to gain the experience needed to compete against established producers. In Brazil and India, for instance, the state prohibited imports of any good for which there was a domestic substitute, regardless of price and quality differences.

The scale and the structure of protection that governments used to promote industrialization are illustrated in [Table 6.4](#), which focuses on Latin America in 1960. In all but two of the listed countries, nominal protection on nondurable consumer goods was well over 100 percent, and for all but three countries, tariffs on consumer durables also were over 100 percent. Mexico and Uruguay stand out as clear exceptions to this pattern, which has more to do with those countries' extensive use of import quotas in place of tariffs than with an unwillingness to protect domestic producers (Bulmer-Thomas 1994, 279). It is also clear that tariffs were lower for semi-manufactured goods, industrial raw materials, and capital goods (all of which were items that developing countries needed to import in connection with industrialization) than they were for consumer goods. This pattern of tariff escalation was common in much of the developing world (Balassa and Associates 1971).

The costs of ISI were borne by agriculture (see Krueger 1993a; Krueger, Schiff and Valdes 1992; Binswanger and Deininger 1997). Governments taxed agricultural exports through marketing boards that controlled the purchase and export of agricultural commodities (Krueger et al. 1992, 16). Often established as the sole entity with the legal right to purchase, transport, and export agricultural products, marketing boards set the price that farmers received for their crops. In the typical arrangement, the marketing board would purchase crops from domestic farmers at prices well below the world price and then would sell the commodities in the world market at the world price. The difference between the price paid to domestic farmers and the world price represented a tax on agricultural incomes that the state could use to finance industrial projects (Amsden 1979; Bates 1988; Krueger 1993a). The trade barriers that protected domestic manufacturing firms from foreign competition also taxed agriculture. Tariffs and quantitative restrictions raised the domestic price of manufactured goods well above the world price. People employed in the agricultural sector, who consumed these manufactured goods, therefore paid more for them than they would have in the absence of tariffs and quantitative restrictions (Krueger 1993a, 9).

TABLE 6.4

Nominal Protection in Latin America, circa 1960 (percent)

	Nondurable Consumer Goods	Durable Consumer Goods	Semi- Manufactured Goods	Industrial Raw Materials	Capital Goods
Argentina	176	266	95	55	98
Brazil	260	328	80	106	84
Chile	328	90	98	111	45
Colombia	247	108	28	57	18
Mexico	114	147	28	38	14
Uruguay	23	24	23	14	27
European Economic Community	17	19	7	1	13

Source: Bulmer-Thomas 1994, 280, Table 9.1.

Such government policies transferred income from rural agriculture to the urban manufacturing and nontraded-goods sectors. The size of the income transfers was substantial. As a World Bank study summarized,

the total impact of interventions ... on relative prices [between agriculture and manufacturing] was in some countries very large. In Ghana ... farmers received only about 40 percent of what they would have received under free trade. Stated in another way, the real incomes of farmers would have increased by 2.5 times had farmers been able to buy and sell under free trade prices given the commodities they in fact produced. While Ghanaian total discrimination against agriculture was huge, Argentina, Cote d'Ivoire, the Dominican Republic, Egypt, Pakistan, Sri Lanka, Thailand, and Zambia also had total discrimination against agriculture in excess of 33 percent, implying that in all those cases, farm incomes in real terms could have been increased by more than 50 percent by removal of these interventions.

(Krueger 1993a, 63)

Thus, ISI redistributed income. The incomes of export-oriented producers fell while those of import-competing producers rose.

A Closer Look

Import Substitution Industrialization in Brazil

In the late nineteenth and early twentieth centuries, Brazil was the classic case of a country that exported primary commodities. Its

principal crop, coffee, accounted for a large share of its production and the overwhelming majority of its export earnings. This economic structure was supported by a political system dominated by the interests of coffee producers and other agricultural exporters (Bates 1997). Political authority in Brazil was decentralized, and the states used their power in the country's federal system to influence government policy. As a result, Brazil pursued a liberal trade policy throughout the late nineteenth and early twentieth centuries. World War I and the Great Depression disrupted these arrangements. The world price for coffee fell sharply in the late 1920s and early 1930s, generating declining terms of trade and rising trade deficits. The government responded to this crisis by adopting protectionist measures to limit imports. The initial turn to protectionism was accompanied by political change. A military coup in 1930 handed power to Getúlio Vargas, who centralized power by shifting political authority from the states to the federal government. Even though Vargas did not adopt an ISI strategy, this period represented in many respects the easy stage of ISI (Haggard 1990, 165–6). Protectionism promoted the growth of light manufacturing industries at a rate of 6 percent per year between 1929 and 1945 (Thorpe 1999, 322). Concurrently, the centralization of power created a state that could intervene effectively in the Brazilian economy. Although the export-oriented interests did not lose all political influence in this new political climate, the balance of power had clearly shifted toward new groups emerging in urban centers: the professionals, managers, and bureaucrats who constituted the emerging middle class and the nascent manufacturing interests. As Brazil moved into the post-World War II period, therefore, the stage was set for the transition to secondary ISI.

A full-blown ISI strategy emerged in the 1950s. The government restricted imports tightly with the so-called law of similars, which effectively prohibited the import of goods similar to those produced in Brazil. In 1952, the Brazilian government created the National Economic Development Bank (BNDE), an important instrument for industrial policy through which the Brazilian state could finance industrial projects. In the late 1950s, the government created a new agency, the National Development Council, to coordinate and plan its industrialization strategy. In taking up its task, the council was heavily influenced by structuralist ideas (Haggard 1990, 174). Studies conducted within these agencies—and, in some instances, in collaboration with international agencies such as the United Nations

(UN) Economic Commission on Latin America—focused on how best to promote industrialization (Leff 1969, 46). Most of these studies came to similar conclusions: industrialization in Brazil would quickly run into constraints caused by inadequate transportation networks (road, rail, and sea), shortages of electric power, and the underdevelopment of basic heavy industries such as steel, petroleum, chemicals, and nonferrous metals. Building up those industries thus became the focus of the government's development policies. The Brazilian government had little faith that the private sector would create and expand these critically important industries. Instead, policymakers determined that the state would have to play a leading role. In the early 1950s, the state nationalized the oil and electricity industries and began investing heavily in the expansion of capacity in both. A similar approach was adopted in the transportation sector (in which the government owned the railways and other infrastructure), in the steel industry, and in telecommunications. By the end of the 1950s, the state accounted for 37 percent of all investment made in the Brazilian economy. As a result, the number of state-owned enterprises grew rapidly, from fewer than 35 in 1950 to more than 600 by 1980.

Beyond creating these basic industries, the Brazilian government also sought to create domestic capacity to produce complex consumer goods. To achieve this objective, Brazil, in contrast to many other developing countries, drew heavily upon foreign investment to promote the development of certain industries. The auto industry is an excellent example. In 1956, the Brazilian government prohibited all imports of cars. Any foreign producer that wanted to sell cars in the Brazilian market would have to set up production facilities in the country. To ensure that such foreign investments were not simple assembly operations in which the foreign company imported all parts from its suppliers at home, the Brazilian government instituted local rules that required the foreign automakers operating in the country to purchase 90 percent of their parts from Brazilian firms. In order to induce foreign automakers to invest in Brazil under these conditions, the government offered subsidies; by one account, the subsidies offset about 87 percent of the total investment between 1956 and 1969. Relying on this strategy, Brazilian auto production rose from close to zero in 1950 to almost 200,000 cars in 1962.

Brazil's ISI strategy helped transform the country's economy in a remarkably short time. Imported consumer nondurable goods (the products targeted during easy ISI) had been almost completely

replaced with domestic production by the early 1950s (Bergsman and Candal 1969, 37). Imported consumer durables, the final goods targeted in secondary ISI, fell from 60 percent of total consumption to less than 10 percent of total consumption by 1959. Imports of capital goods also fell, from 60 percent of total domestic consumption in 1949, to about 35 percent of consumption in 1959, and then to only 10 percent by 1964. Finally, imports of intermediate goods, the inputs used in producing final goods, also fell continually throughout the decade, to less than 10 percent of total consumption by 1964. Thus, as imports were barred and domestic industries created, Brazilian consumers and producers purchased a much larger percentage of the goods they used from domestic producers and a much smaller percentage from foreign producers. As a consequence, the importance of manufacturing in the Brazilian economy increased sharply: whereas manufacturing accounted for only 26 percent of total Brazilian production in 1949, by 1964 it accounted for 34 percent.

The strategy of ISI promoted rapid economic growth in the 1960s and 1970s: developing countries' economies grew at annual average rates of between 6 percent and 7.6 percent during this period. In many countries, it was the manufacturing sector that drove economic growth. Argentina, Brazil, Chile, Mexico, Mozambique, Nigeria, Pakistan, and India, to select only a few examples, all enjoyed average annual rates of manufacturing growth between 5 percent and 10 percent during the 1960s. A glimpse back at [Table 6.1](#) indicates that, in Latin America, manufacturing's share of the total economy increased substantially between 1960 and 1980. Thus, although the policies that governments adopted had important effects on the distribution of income, they also appeared to be transforming developing societies into industrialized economies.

Reforming the International Trade System

Developing countries also tried to alter the rules governing international trade. For many developing-country governments, these efforts reflected their experience with colonialism. India's perspective was not unique: international trade was "a whirlpool of economic imperialism rather than a positive instrument for achieving economic growth" (Srinivasan and Tendulkar 2003, 13). Consequently, as early as 1947, India, Brazil, and Chile were arguing that the multilateral rules the United States and Great Britain were writing failed to address the economic problems that

developing countries faced (Kock 1969, 38–42). Advancing the infant-industry justification for protection, many developing countries argued that their firms could not compete with established producers in the United States and Europe. Yet, GATT rules not only made no provision for the infant-industry justification for protection but indeed, explicitly prohibited the use of quantitative restrictions and tightly restricted the use of tariffs. Developing countries insisted that they be given a relatively free hand in the use of trade restrictions to promote economic development, because the GATT failed to do so.

Developing countries continued to press for GATT reforms throughout the 1950s (see Kock 1969, 238; Finger 1991). By the early 1960s, a coalition of developing countries dedicated to far-reaching reform had emerged. Its first important success was achieved with the formation of the **United Nations Conference on Trade and Development (UNCTAD)** in March of 1964. The UNCTAD was established as a body dedicated to promoting the interests of developing countries in the world trade system. At the conclusion of this first UNCTAD conference, 77 developing-country governments signed a joint declaration calling for reform of the international trade system. Thus was born the **Group of 77**, the leading force in the campaign for systemic reform. During the next 20 years, trade relations between the developing world and the advanced industrialized countries revolved almost wholly around competing conceptions of international trade rules embodied in the GATT and UNCTAD.

During the 1960s, the Group of 77 used UNCTAD to pursue three international mechanisms that would increase their share of the gains from trade (Kock 1969; UNCTAD 1964; Williams 1991). First, the Group of 77 sought commodity price stabilization schemes. Commodity price stabilization was to be achieved by setting a floor below which commodity prices would not be allowed to fall and by creating a finance mechanism, funded largely by the advanced industrialized countries, to purchase commodities when prices fell below the floor. Stabilizing commodity prices would be an important step toward stabilizing developing countries' terms of trade (recall the Singer-Prebisch hypothesis). The Group of 77 also sought direct financial transfers from the advanced industrialized countries to compensate them for the purchasing power they were losing from declining terms of trade (UNCTAD 1964, 80). Developing countries also sought greater access to core-country markets, pressuring the advanced industrialized countries to eliminate trade barriers on primary commodities and to provide manufactured exports from developing countries with preferential access to the core-countries' markets.

These reform efforts yielded few concrete results. Core countries agreed to incorporate concerns specific to developing countries into the GATT charter. In 1964, three articles focusing on developing countries were included in the **GATT Part IV**. Part IV called upon core countries to improve market access for commodity exporters, to refrain from raising barriers to the import of products of special interest to the developing world, and to engage in “joint action to promote trade and development” (Kock 1969, 242). In the absence of meaningful changes in the trade policies pursued by the advanced industrialized countries, however, Part IV provided few concrete gains. The advanced industrialized countries also allowed the developing countries to opt out of strict reciprocity during GATT tariff negotiations. The developing countries that belonged to the GATT were therefore able to benefit from tariff reductions without having to offer concessions in return. Benefits from this concession were more apparent than real, however: GATT negotiations focused primarily on manufactured goods produced by the advanced industrialized countries and excluded agriculture, textiles, and many other labor-intensive goods. Developing countries were therefore exporting few of the goods on which the advanced industrialized countries were actually reducing tariffs. In the late 1960s, the advanced industrialized countries agreed to the **Generalized System of Preferences (GSP)**, under which manufactured exports from developing countries gained preferential access to advanced industrialized countries’ markets. This concession, too, was of limited importance, because advanced industrialized countries often limited the quantity of goods that could enter under preferential tariff rates and excluded some manufacturing sectors from the arrangement entirely.

Even though their efforts during the 1960s had achieved few concrete gains, the Group of 77 escalated its demands in the early 1970s. Escalated demands were sparked by the 1973 oil shock. The oil shock was a clear illustration of the potential for commodity power. The world’s major oil-producing countries, working together in the Organization of Petroleum Exporting Countries (OPEC), used their control of oil to improve their terms of trade. OPEC’s ability to use commodity power to extract income from the core countries strengthened the belief within the Group of 77 that commodity power could be exploited to force fundamental systemic change.

Greater confidence in the possibilities that their control of commodities offered led the Group of 77 to develop a set of radical demands dubbed the **New International Economic Order (NIEO)**. The NIEO represented an attempt to create an international trade system whose operation would

promote development (see Krasner 1985). The NIEO, which the UN General Assembly adopted in December 1974, embodied a set of reforms that would have radically altered the operation of the international economy. In addition to the three mechanisms that developing countries had demanded during the 1960s, the NIEO included rules that would grant developing countries greater control over multinational corporations operating in their countries, easier and cheaper access to northern technology, a reduction in foreign debt, increased foreign aid flows, and a larger role in the decision-making processes of the World Bank and International Monetary Fund (IMF).

Governments in the advanced industrialized countries refused to make significant concessions, and by the mid-1980s the NIEO had disappeared from the international agenda. The failure of the NIEO has been attributed to a number of factors. First, developing countries were unable to establish and maintain a cohesive coalition. The heterogeneity of developing countries' interests made it relatively easy for the advanced industrialized countries to divide the Group of 77 by offering limited concessions to a small number of governments in exchange for defection from the broader group. In addition, the Group of 77 had hoped that OPEC would assist it by linking access to oil to acceptance of the NIEO. But OPEC governments were unwilling to use their oil power to help other developing countries achieve broader trade and development objectives.

Most importantly, however, by the early 1980s, many developing countries were facing serious balance-of-payments problems and turned to the IMF and the World Bank for financial support. The need to obtain IMF and World Bank assistance altered the balance of power in favor of the advanced industrialized countries. This power shift sparked a reform process that changed fundamentally development strategies throughout the developing world.

CONCLUSION

Throughout much of the postwar period, developing countries insulated themselves from the world trade system. The interaction between domestic politics on the one hand, and economic shocks and decolonization on the other, generated governments that were highly responsive to the interests of import-competing manufacturing industries and a growing class of urban workers. Influenced greatly by structuralism, most governments transformed the political incentive to protect these domestic industries into ambitious state-led development strategies. Structuralism's critique of the

ability of domestic and international markets to promote industrialization led governments to intervene in domestic markets to overcome the market imperfections that reduced private incentives to invest in manufacturing activities.

Policy Analysis and Debate

The Sustainable Development Goals

Question

Can the Sustainable Development Goals eradicate extreme poverty?

Overview

Members of the UN agreed in 2015 that for the next 15 years they would focus their development policies on 17 **Sustainable Development Goals** (SDGs). The SDGs constitute an ambitious attempt to build on the gains realized through the Millennium Development Goals, and include (among other things) end extreme poverty everywhere (measured as living on less than \$1.25 per day) and cut the numbers living in poverty in half by 2030. In addition, the SDGs place greater emphasis on sustainable development—and thus have a variety of environmental goals—and they attach greater importance to protection of human rights. Governments are to achieve these goals through extensive planning at the domestic and international levels. Policies based on these plans will in turn be supported by foreign aid offered by the international community. For that purpose, the UN has called upon rich countries to provide aid equal to 0.7 percent of GDP to developing countries and provide technical assistance and technology transfers where it is useful to do so.

The logic upon which SDGs rest is similar to the thinking that at the broad level shaped the government's role in ISI. The SDGs rest on a diagnosis of poverty that emphasizes structural factors. Rather than emphasize market failure, however, contemporary thinking emphasizes a "poverty trap":

When poverty is extreme, the poor do not have the ability—by themselves—to get out of the mess ... When [people] are utterly destitute, they need their entire income, or more, to survive ... There is no

margin of income above survival that can be invested for the future.
(Sachs 2005, 56)

People can escape the poverty trap with help from the contemporary analogue of the “big push.” The international community must provide “a leg up” through well-funded and well-conceived government policy initiatives. Given the logic upon which they are based, do you think the SDGs will be successful?

Policy Options

- An SDG-like strategy is necessary if the world is to eradicate extreme poverty. Governments must embrace these goals.
- The SDGs rest on faulty logic and thus cannot reduce extreme poverty. Governments should re-evaluate their approach to the problem of global poverty.

Policy Analysis

- Do developing-country governments have incentives to implement the policies called for by the SDG strategy? Why or why not?
- Do advanced industrialized countries have incentives to provide the foreign aid that is required to support SDG policies? Why or why not?

Take a Position

- Which option do you prefer? Justify your choice.
- What criticisms of your position should you anticipate? How would you defend your recommendation against these criticisms?

Resources

Online: To learn more about the SDGs and current progress toward achieving them, conduct an online search for the keywords *UN* and *MDGs*. Look especially for the UN’s annual progress reports.

In Print: Read the alternative perspectives embodied in Jeffrey Sachs’ *Ending Poverty: Economic Possibilities of Our Time* (New York: Penguin Press, 2005), and William Easterly’s *The White Man’s*

Burden: Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good (New York: Penguin Publishers, 2006).

To the extent that developing countries participated in the global trade system, they sought to achieve far-reaching reform of the rules governing the system. Again, the structuralist critique served an important role in this effort, as it suggested that developing countries could not expect to gain from trade with the advanced industrialized countries until they themselves had industrialized. Moreover, structuralism claimed that trade based on GATT rules would only make industrialization harder to achieve. Rather than accept participation in the global economy on what they viewed as vastly unequal terms, developing countries battled to change the rules governing international trade in order to capture a larger share of the available gains. Thus, an international struggle over the distribution of the gains from trade arose as an important counterpart of the domestic strategy of redistributing resources from agriculture to industry embodied in ISI.

KEY TERMS

Backward Linkages
Big Push
Complementary Demand
Easy ISI
Enclave Agriculture
Export Substitution Strategy
GATT Part IV
Generalized System of Preferences
Group of 77
Import Substitution Industrialization
Monoexporters
New International Economic Order
Pecuniary External Economies
Secondary ISI
Singer-Prebisch Theory
Structuralism
Sustainable Development Goals
Terms of Trade
United Nations Conference on Trade and Development

SUGGESTIONS FOR FURTHER READING

For a readable introduction to structuralism and development strategies more

generally, see Ian Little, *Economic Development* (New York: Basic Books, 1982). For an in-depth look at Latin America, see Victor Bulmer-Thomas, *The Economic History of Latin American since Independence*, 3rd edition (Cambridge: Cambridge University Press, 2014).

For a comparative study of the role of the state in development, see Atul Kohli, *State-Directed Development: Political Power and Industrialization in the Global Periphery* (Cambridge: Cambridge University Press, 2004).

For a detailed examination of the New International Economic Order, see the recent special issue of *Humanity* (2015 6 (1), <http://humanityjournal.org/issue-6-1/>), Paul Adler, 2017. “‘The Basis of a New Internationalism?’ The Institute for Policy Studies and North-South Politics from the NIEO to Neoliberalism.” *Diplomatic History* 41(4): 665–93, and the now classic, Stephen Krasner, *Structural Conflict: The Third World against Global Liberalism* (Berkeley: University of California Press, 1985).

CHAPTER 7

Trade and Development II: Neoliberalism and Institutionalism

Whereas structuralism and import substitution industrialization (ISI) shaped development strategies during the first 35 years of the postwar period, the last 30 years have been dominated by neoliberalism and export-oriented industrialization. In contrast to structuralism, with its skepticism about the market and faith in the state, neoliberalism is highly skeptical of the state's ability to allocate resources efficiently and places great faith in the market's ability to do so. And in contrast to structuralism's advocacy of protectionism and state intervention, neoliberalism advocates the state's withdrawal from the economy, the reduction (ideally, elimination) of trade barriers, and reliance on the market to generate industries that produce for the world market. In addition, the current consensus within the development community stresses the critical importance for development outcomes of high-quality political and economic institutions.

Like structuralism, neoliberalism has dramatically affected policy. Across the developing world, governments have reduced tariffs and removed other trade barriers, thereby opening their economies to imports. They have sold state-owned enterprises to private groups. They have deregulated their economies to allow prices to reflect the underlying scarcity of resources. They have shifted their emphasis from producing for the domestic market to producing for the global market. Countries that had never joined the General Agreement on Tariffs and Trade (GATT) sought membership in the World Trade Organization (WTO). Thus, the last 30 years have brought a complete reversal of the development strategies that most governments had adopted. Belief in the power of states has been replaced by belief in the efficacy of the market; skepticism about trade has

been replaced by concerted efforts to integrate deeply into the world trade system. Neoliberalism has replaced structuralism as the guiding philosophy of economic development. And as the state retreated from the economy, the development community began to place new emphasis on how important it was to development to have good political and economic institutions.

The shift from structuralism to neoliberalism emerged from the interplay between three developments in the global economy. First, by the early 1970s, ISI was generating economic imbalances. The emergence of these imbalances suggested that economic reform of some type was required, although it did not point to a specific solution. Second, at about the same time, it was becoming apparent that a small group of East Asian economies were outperforming all other developing countries based on what many viewed as a neoliberal strategy. Third, a severe economic crisis in the early 1980s forced governments to embark on reform, and as they did, the International Monetary Fund (IMF) and World Bank strongly encouraged them to base reform on the neoliberal model.

We examine each of these three developments. We look first at the factors that caused ISI to generate economic imbalances. This examination allows us to understand the problems ISI created and the reasons that reform of some type was necessary. We then turn our attention to the East Asian countries. We briefly compare their performance with that of the rest of the developing world. We next examine two contrasting explanations for this remarkable performance, one that emphasizes the neoliberal elements of those countries' strategies and one that emphasizes the role East Asian states played in the development process. We then turn to the economic crisis and reform. We look at how the crisis pushed developing countries to the World Bank and the IMF, and at how these two institutions shaped the content of the reforms governments adopted. In the final section, the chapter explores the relationship between domestic political institutions and economic development.

EMERGING PROBLEMS WITH IMPORT SUBSTITUTION INDUSTRIALIZATION

By the late 1960s, ISI was generating two important economic imbalances, which together suggested that it had reached the limits of its utility as a development strategy. The first imbalance lay in government budgets. ISI tended to generate persistent budget deficits because it prescribed heavy government involvement in the economy. Since governments believed that

the private sector would not invest in industries that were important for the success of secondary ISI, governments themselves often made the investments, either in partnership with private-sector groups or alone by creating state-owned enterprises.

Yet, many of these state-owned enterprises never became profitable. By the late 1970s, state-owned enterprises in developing countries were running combined operating deficits that averaged 4 percent of gross domestic product (GDP) (Waterbury 1992, 190). Governments kept these enterprises afloat by using funds from the state budget. Government investment and the subsequent need to cover the losses of state-owned enterprises combined to generate large and persistent budget deficits throughout the developing world.

Domestic politics aggravated the budget deficits generated by ISI. For many governments, urban residents provided critical political support. Governments maintained this support by subsidizing essential items. Electricity, water and sewers, transportation, telephone service, and food were all made available to urban residents at below-market prices. This was possible only by using government revenues to cover the difference between the true cost and the price charged. In addition, many governments expanded the civil service to employ urban dwellers. In Benin, for example, the civil service tripled in size between 1960 and 1980, not because the government needed so many civil servants, but because the government used it to employ urban residents in order to maintain support. Such practices added to government expenditures and added nothing to government revenues, thereby worsening the budget deficit.

ISI also generated a second important imbalance: persistent current-account deficits. The **current account** registers a country's imports and exports of both goods and services. A current-account deficit means that a country is importing more than it is exporting. Import substitution gave rise to current-account deficits because it generated a considerable demand for imports while simultaneously reducing the economy's ability to export. Somewhat ironically, ISI depended on imports. Industrialization required countries to import the necessary machines, and once these machines were in place, production required continued import of parts that were not produced in the domestic economy.

Exports declined for two reasons. First, the manufacturing industries created through import substitution were not competitive in international markets. Production in many of the heavy industries that governments targeted in secondary ISI was characterized by economies of scale. The

domestic market in most developing countries, however, was too small to allow domestic producers to realize economies of scale. These inefficiencies were compounded by excess capacity—the creation of more production capacity than the domestic market could absorb (see Little, Scitovsky, and Scott 1970, 98). Consequently, the newly created manufacturing industries could not export to the world market.

Second, the policies that governments used to promote industrialization weakened agriculture. The decline in agricultural production was most severe in sub-Saharan African countries, which, as a region, taxed farmers heavily (Schiff and Valdés 1992). Heavy tax burdens reduced farmers' incentives to produce, hence the rate of growth of agriculture declined. In Ghana, for example, the real value of the payments that cocoa farmers received from the government marketing board fell by about two-thirds between 1960 and 1965. Falling prices gave cocoa farmers little incentive to invest in order to maintain, let alone increase, cocoa output (Killick 1978, 119). In addition, cocoa farmers smuggled much of what they did produce into the Ivory Coast, where they could sell cocoa at world prices (Herbst 1993, 40).

These microeconomic inefficiencies were reinforced by the tendency of most governments to maintain overvalued exchange rates. Ideally, a government should maintain an exchange rate that equalizes the prices of goods in the domestic and foreign markets. However, under ISI, many governments set the exchange rate higher than that, and as a result, foreign goods were cheaper in the home market than they should have been and domestic goods were more expensive in foreign markets than they should have been. Because foreign goods were underpriced in the domestic market, capital goods and intermediate inputs could be acquired from abroad at a lower cost than they could be produced at home. This difference in price created a strong incentive to import, rather than creating the capacity to produce the goods locally. The result was rising imports. Because domestic goods were overpriced in foreign markets, domestic producers, even when efficient, found it difficult to export.

The emergence of budget deficits and current-account deficits indicated that ISI was creating an economic structure that couldn't pay for itself. Many of the manufacturing industries created during secondary ISI could not sell their products at prices that covered their costs of production. Many developing countries could not export enough to pay for the imports demanded by the manufacturing industries they were creating. Such imbalances could not persist forever; some reform was clearly necessary.

Yet, the domestic politics of ISI greatly constrained the ability of

governments to implement reforms. The balance of power among domestic interest groups created multiple veto players that limited the ability of governments to alter policies. Because governments depended so heavily on urban residents for political support, they could not easily reduce benefits provided to that group (Waterbury 1992, 192). In 1971, for example, the Ghanaian prime minister devalued the exchange rate in an attempt to correct Ghana's current-account deficit. Concern that devaluation would raise the prices of many imported goods consumed by urban residents contributed to a coup against the government a few days later. Once in power, the new regime quickly restored the currency to its previous rate (Herbst 1993, 22–23). What message did that send to politicians who might be contemplating measures to address the economic imbalances they were facing?

In addition, the administration of ISI had created opportunities for rent seeking and other corrupt practices. Those who engaged in these activities had a vested interest in the continuation of the system. On the one hand, government intervention had established an environment conducive to **rent seeking** (Krueger 1974; Bhagwati 1982)—efforts by private actors to use the political system to achieve a higher-than-market return on an economic activity. Consider, for example, the consequences of government controls on imports. Governments controlled imports by requiring all residents who wanted to import something to first gain the permission of government authorities. Such restrictions meant that imported goods were scarce, thus imports purchased at the world price could be sold at a much higher price in the domestic market. The difference between the world price and the domestic price provided a rent to the person who imported the good. A government license to import, therefore, was valuable. Consequently, people had incentives to pay government civil servants to acquire licenses, and government civil servants had incentives to sell them.

Such behavior was extraordinarily costly. It has been estimated, for example, that rent seeking cost India about 7 percent and Turkey about 15 percent of their national incomes during the 1960s (Krueger 1974, 294). Because so many people inside the government and in the economy were benefiting from the opportunities for rent seeking, they had a very strong incentive to resist any efforts by the government to dismantle the system.

Finally, even if governments could overcome these obstacles, it was unclear what model they should shift to. Far-reaching reforms would require them to re-evaluate the underlying strategy they were using to industrialize. The only available alternative to ISI was a market-oriented

development strategy (one we will look at in detail in the next section). In the 1970s, however, it was precisely this strategy that the Group of 77 was fighting against in the UNCTAD and with the NIEO. Even moderate reforms held little appeal. Most governments were unwilling to scale back their industrialization strategies. Instead, they looked for a way to cover the twin deficits without having to scale back their ambitious plans.

Facing economic imbalances, unable and unwilling to change policy, many governments sustained ISI by borrowing from abroad. Yet foreign loans could provide only a temporary solution; foreign lenders would eventually question whether loans could be repaid. When they concluded that they couldn't, they would be unwilling to lend more, and governments would be forced to correct budget and current-account deficits. This point arrived in the early 1980s and ushered in a period of crisis and reform. Before we examine this period, however, we must look at economic developments in East Asia as these developments played a critical role in shaping the content of the reforms adopted throughout the developing world after 1985.

THE EAST ASIAN MODEL

Whereas ISI was generating imbalances in Latin America and sub-Saharan Africa, four East Asian economies—Hong Kong, Singapore, South Korea, and Taiwan—were realizing dramatic gains on the basis of a very different development strategy. The dramatic performance gap is evident in three economic indicators (see [Table 7.1](#)).

- Per capita income in East Asia grew almost three times faster than in Latin America and South Asia and more than 26 times higher than in sub-Saharan Africa.
- Manufacturing output grew by 10.3 percent per year between 1965 and 1990. No other developing country came close to this growth for the period as a whole.
- Exports from East Asia grew 8.5 percent per year between 1965 and 1990 while exports from Latin America shrank by 1 percent per year.

TABLE 7.1

Comparative Economic Performance, Selected Developing Countries (Average Annual Rates of

Change)*

	1965–1990	1985–1995
Growth of per Capita GNP		
East Asia and the Pacific	5.3	7.2
Sub-Saharan Africa	0.2	1.1
South Asia	1.9	2.9
Latin America and the Caribbean	1.8	0.3
Growth of Manufacturing		
East Asia and the Pacific	10.3	15.0
Sub-Saharan Africa	n.a.	0.2
South Asia	4.5	5.3
Latin America and the Caribbean	8.3	2.5
Growth of Exports		
East Asia and the Pacific	8.5	9.3
Sub-Saharan Africa	6.1	0.9
South Asia	1.8	6.6
Latin America and the Caribbean	2.1	5.2

Notes: n.a. = not available.

GNP = gross national product.

Source: World Bank, *World Development Report*, various issues.

As a consequence, manufacturing grew in importance in East Asia, while the importance of agriculture diminished. This differed substantially from ISI countries, where agriculture's importance fell but manufacturing failed to grow (see [Table 6.1](#)). The growing manufacturing sector transformed the composition of East Asia's exports (see [Table 6.2](#)). By the mid-1990s, manufactured goods accounted for more than 80 percent of East Asian exports. By contrast, only in Brazil, Mexico, India, and Pakistan did manufactured goods account for more than 50 percent of total exports by the 1990s, and most of these gains were realized after 1980. Finally, per capita incomes in East Asia soared above those in other developing countries ([Table 7.2](#)). In 1960, per capita incomes in East Asia were lower than per capita incomes in Latin America; by 1990, East Asian incomes were higher than—in some cases twice as large as—per capita incomes in Latin America.

Why did East Asian countries outperform other developing countries by such a large margin? Most people who study East Asian development

agree that the countries in the region distinguished themselves from other developing countries by pursuing export-oriented development. In an **export-oriented strategy**, emphasis is placed on producing manufactured goods that can be sold in international markets. Scholars disagree about the relative importance of the market and the state in creating export-oriented industries. One position, the neoliberal interpretation, is articulated most forcefully by the IMF and the World Bank. This thesis argues that East Asia's success was a consequence of market-friendly development strategies. In contrast, the state-oriented interpretation, advanced by many specialists in East Asian political economy argues that East Asia's success is due in large part to state-led industrial policies.

TABLE 7.2

Gross National Product per Capita, Selected Developing Countries (1996 U.S. Dollars)

	1960	1990	2000	Percent Change 1960–2000
Hong Kong	3,090	20,827	26,699	764
Singapore	2,161	17,933	24,939	1,054
Taiwan	1,430	10,981	17,056	1,093
South Korea	1,495	9,952	15,876	962
Mexico	3,980	7,334	8,762	120
Malaysia	2,119	6,525	9,919	368
Argentina	7,371	7,219	11,006	49
Chile	3,853	6,148	9,926	158
Brazil	2,371	6,218	7,190	203
Thailand	1,091	4,833	6,857	528
Zaire/Congo	980	572	281	-71
Indonesia	936	2,851	3,642	289
Pakistan	633	1,747	2,008	217
India	847	1,675	2,479	193
Nigeria	1,033	1,095	707	-32
Kenya	796	1,336	1,244	56
Zambia	1,207	1,021	892	-26
Tanzania	382	494	482	26

Sources: Penn World Tables; Data for 1996, Data for 1997; Data for 1998.

The IMF and the World Bank contend that East Asia's economic success derived from the adoption of a neoliberal approach to development. This interpretation places particular emphasis on the willingness of East Asian governments to embrace international markets, and their ability to maintain stable macroeconomic environments (see World Bank 1989, 1991, 1993; Little 1982; Lal 1983; for critiques, see Toye 1994 and Rodrik 1999). Most East Asian governments adopted ISI strategies in the immediate postwar period. Unlike governments in Latin America and Africa, however, East Asian governments shifted to export-oriented substitution once they had exhausted the gains from easy ISI. In Taiwan, for example, the government shifted in 1958 from production for the domestic market to a strategy that emphasized production for export markets. South Korea adopted similar reforms in the early 1960s. A second wave of newly industrializing countries (NICs)—a group that includes Indonesia, Malaysia, and Thailand—followed the same path starting in the late 1960s (World Bank 1993). The emphasis on exports forced Asian manufacturing firms to worry about international competitiveness. As a result, the World Bank and the IMF argue, Asian societies invested their resources in domestic industries profitable in world markets.

The shift to export-oriented strategies was followed by selective import liberalization. Asian governments did not engage in wholesale import liberalization. The Taiwanese and South Korean governments continued to rely heavily on tariff and non-tariff barriers to protect domestic markets. In Taiwan, for example, approximately two-thirds of imports were subject to some form of tariff or non-tariff barrier greater than 30 percent, and as late as 1980 more than 40 percent of imports faced protection greater than 30 percent (World Bank 1993, 297). A similar pattern appeared in South Korea, where, as late as 1983, “most sectors were still protected by some combination of tariffs and nontariff barriers” (World Bank 1993, 297). However, selective liberalization helped promote exports by reducing the cost of critical inputs. Reducing tariffs on key intermediate goods, such as looms and yarn in the textile industry, enabled domestic producers to acquire inputs at world prices. This kept exports competitive in international markets.

East Asian governments also maintained stable macroeconomic environments. Three elements of the macroeconomic environment were particularly important. First, inflation was much lower in East Asia than in other developing countries. Between 1961 and 1991, inflation averaged only 7.5 percent in the East Asian economies. By contrast, annual inflation

rates in the rest of the developing world averaged 62 percent (World Bank 1993, 110). Second, because governments kept inflation under control, they could maintain appropriately valued exchange rates. In many developing countries, high inflation caused the domestic currency to rise in value against foreign currencies, making exporting difficult. In the East Asian countries, by contrast, governments were able to maintain exchange rates that allowed domestic firms to remain competitive in foreign markets. Third, East Asian governments pursued relatively conservative fiscal policies. They borrowed little, and when they did borrow, they tapped domestic savings rather than turning to international financial markets. This approach was in stark contrast to Latin American governments, which accumulated large public-sector deficits financed with foreign capital.

This stable macroeconomic environment had beneficial consequences for Asian economic performance. Low inflation promoted high savings rates and investment (World Bank 1993, 12). Savings rates in the Asian NICs averaged more than 20 percent of GDP per year, almost twice the level attained in other developing countries, whereas investment rates were 7 percentage points of GDP higher, on average, than in other developing countries (World Bank 1993, 16, 221). A stable macroeconomic environment also made it easier to open the economy to international trade. Because inflation was low and exchange rates were maintained at appropriate levels, trade liberalization did not generate large current-account deficits. Finally, the ability to maintain relatively stable and appropriately valued real exchange rates encouraged private actors to invest in export-oriented industries.

The interaction between the export orientation, the relatively liberal import policy, and the stable macroeconomic environment promoted economic development. As Doner and Hawes (1995, 150) summarize the World Bank perspective, the

pattern of limited government intervention in the market, coupled with cheap labor and an open economy, [has] guaranteed the private sector stability and predictability, the means to achieve competitiveness on a global scale, and access to the international market so that entrepreneurs could actually discover areas where they have comparative advantage. In shorthand, the model is often reduced to “getting the prices right” and letting market-based prices determine resource allocation. Doing so results in export growth that is in turn positively correlated with broader economic growth.

According to the World Bank and the IMF, East Asia succeeded because

markets played a large role, and states played a small role, in allocating resources.

Other scholars have argued that East Asia's success had less to do with allowing markets to work and much more to do with well-designed government industrial policies (see Wade 1990; Amsden 1989; Haggard 1990). In what has come to be called the **East Asian model of development**, economic development is conceptualized as a series of distinct stages. Government intervention in each stage identifies and promotes specific industries likely to be profitable in the face of international competition. In the first stage, industrial policy promotes labor-intensive light industry, such as textiles and other consumer durables. In the second stage, industrial policy emphasizes heavy industries such as steel, shipbuilding, petrochemicals, and synthetic fibers. In the third stage, governments target skill- and research and development (R&D)-intensive consumer durables and industrial machinery, such as machine tools, semiconductors, computers, telecommunications equipment, robotics, and biotechnology. Governments design policies and organizations to promote the transition from one stage to the other (Wade 1994, 70).

These three stages of industrialization are evident in the paths traced by Taiwan and South Korea (see [Table 7.3](#)). In Taiwan, industrialization focused initially on light manufacturing, textiles in particular. By the mid-1950s, textiles were Taiwan's most important export. The government also encouraged production of simple consumer durable goods such as television sets. In the late 1950s, the Taiwanese government began to emphasize heavy industries. A joint venture between several Taiwanese firms and an American firm was formed in 1954 to produce synthetic fibers (Wade 1990, 80). In 1957, a plant to produce polyvinyl chloride was constructed under government supervision and then was handed to a private entrepreneur, Y. C. Wang (Wade 1990, 79). The government created state-owned enterprises in the steel, shipbuilding, and petrochemical industries. During the 1970s, attention shifted to skill-intensive industries, with particular emphasis on machine tools, semiconductors, computers, telecommunications, robotics, and biotechnology (Wade 1990, 94). By the mid-1980s, electrical and electronic goods had replaced textiles as Taiwan's largest export (Wade 1990, 93).

TABLE 7.3

Stages of Industrialization in Taiwan and South Korea, 1880–1968

	Commodity Exports 1880–1930	Primary ISI* 1930–1955	Primary Export-Oriented Industries 1955–1968
Main Industries	Taiwan: Sugar, rice South Korea: Rice, beans	Taiwan and South Korea: Food, beverages, tobacco, textiles, clothing, cement, light manufactures (wood, leather, rubber, and paper products)	Taiwan and South Korea; Textiles and apparel, electronics, plywood, plastics (Taiwan), wigs (South Korea), intermediate goods (chemicals, petroleum, paper, and steel products)
Major Economic Actors	Taiwan and South Korea: Local producers (colonial Japan)	Taiwan and South Korea: Private national firms	Taiwan and South Korea: National private firms, multinational corporations, state-owned enterprises
Orientation of the Economy	External markets	Internal market	External markets

* ISI, import substitution industrialization.

Source: Gereffi 1990, 19.

The South Korean government adopted similar policies (Amsden 1989). In the 1950s, the government emphasized textile production, and textiles became South Korea's first important manufacturing export. During the late 1960s, the South Korean state initiated the development of the chemical and heavy-machinery industries. It created the Pohang Iron and Steel Company, known as POSCO, which subsequently became one of the world's leading steel producers. The government also provided extensive support to Hyundai Heavy Industry, a shipbuilder that subsequently became a world leader in this industry. Then in the late 1970s, the South Korean government began to give priority to skill- and R&D-intensive

sectors, and it is during this period that the South Korean electronics and automobile industries began to emerge (Amsden 1989).

In the East Asian model of development therefore, government policy drives industrialization from low-skilled, labor-intensive production to capital-intensive forms of production and from there to industries that rely on high-skilled labor and technology-intensive production. Each stage is associated with particular types of government policies, and as each stage reaches the limits of rapid growth, emphasis shifts to the next stage in the sequence (Wade 1994, 71). Moreover, at each stage, governments stress the need to develop internationally competitive industries.

East Asian governments relied heavily on industrial policies. They used industrial policy to achieve four policy goals: reduce the cost of investment funds in targeted industries, create incentives to export, protect infant industries, and promote the acquisition and application of skills. Taiwan and South Korea created incentives to invest in industries that state officials identified as critical to development. To do so, governments in both countries provided firms investing in these industries with preferential access to low-cost credit. In South Korea, the government nationalized the banks in the early 1960s and in the ensuing years fully controlled investment capital. Control of the banks allowed the government to provide targeted sectors with access to long-term investment capital at below-market rates of interest (Haggard 1990, 132). Although the banking sector was not nationalized in Taiwan, the government did influence banks' lending decisions. During the 1960s, banks were provided with government-formulated lists of industries that were to receive preferential access to bank loans. During the 1970s, the banks themselves were required to select five or six industries to target in the coming year. As a result, about 75 percent of investment capital was channeled to the government's targeted industries (Wade 1990, 166).

Asian governments also implemented policies that encouraged exports. One method linked access to investment funds at low interest rates to export performance. In Taiwan, for example, firms that exported paid interest rates of only 6–12 percent, whereas other borrowers paid 20–22 percent (Haggard 1990, 94). In South Korea, short-term loans were extended “without limit” to firms with confirmed export orders (Haggard 1990, 65). Credit was also made available to exporters' input suppliers and to these suppliers' suppliers (Haggard 1990, 65–66). In addition, “deliberately undervalued exchange rates” improved the competitiveness of exports in international markets (World Bank 1993, 125). Finally, a variety of measures ensured that domestic firms could purchase their

intermediate inputs at world prices. These measures often entailed the creation of free-trade zones and export-processing zones—areas of the country into which intermediate goods could be imported duty free as long as the finished goods were exported. Export-processing zones allowed domestic producers to avoid paying tariff duties that would raise the final cost of the goods they produced.

The Taiwanese and South Korean governments also protected infant industries at each stage. In some instances, the measures they used were straightforward forms of protection. The South Korean government, for example, enacted legislation in 1983 that “prohibited the import of most microcomputers, some minicomputers, and selected models of disk drives,” in order to protect domestic producers in the computer industry (Amsden 1989, 82). POSCO initially produced steel behind high import barriers. In other instances, protection was less transparent. Hyundai Heavy Industry, for instance, was protected in part through a government policy that required Korean oil imports to be carried in ships operated by a merchant marine that Hyundai Heavy Industry had itself created (Amsden 1989, 273). Taiwan adopted similar policies.

Finally, the Taiwanese and South Korean governments put in place policies that raised skill levels. Investments in education were made to improve labor skills. In Taiwan, enrollment in secondary schools had reached 75 percent of the eligible age group by 1980. Enrollment increases were accompanied by rising expenditures on education; per pupil expenditures increased eightfold in primary schools, threefold in secondary schools, and twofold at the university level between the early 1960s and 1980s (Liu 1992, 369). Similar patterns are evident in South Korea, where enrollment in secondary schools increased from 35 percent in 1965 to 88 percent in 1987 and “real expenditures per pupil at the primary level rose by 355 percent” (World Bank 1993, 43, 45).

Governments also invested in scientific infrastructure to facilitate the application of skills to R&D activities. In Taiwan, the Industrial Technology Research Institute was formed in 1973, and nonprofit organizations were created during the 1970s to perform research and disseminate the results to firms in the private sector. A science-based industrial park designed to realize agglomeration effects was created in 1980 (Haggard 1990, 142). In South Korea, tax incentives were used to induce chaebols, the large South Korean firms, to create laboratories for R&D purposes. An industrial estate for computer and semiconductor production was created, and the Electronics and Telecommunications Research Institute, a government-funded institute oriented toward product

development was established there (Amsden 1989, 82). These policies raised skill levels and created an infrastructure that allowed the more highly skilled labor force to work to its full potential. This skill upgrading was critical to the transition to the third stage of the industrialization process.

The two explanations discussed thus present different arguments for East Asia's success. One suggests that East Asia succeeded because governments allowed markets to work. The other suggests that East Asia succeeded because governments used industrial policy to promote economic outcomes that the market could not produce. Which argument is correct? Although we lack definitive answers, we may conclude that both explanations have value. By "getting prices right," the export orientation and the stable macroeconomic environment encouraged investments in industries in which East Asian countries had, or could develop, comparative advantage. By targeting sectors where comparative advantage could be created, by reducing the costs of firms operating in those sectors, by encouraging firms to export, and by upgrading skills, industrial policy encouraged investments in areas that could yield high returns. As Stephan Haggard (1990, 67) has summarized, macroeconomic "and trade policies established a permissive framework for the realization of comparative advantage, and more targeted policies pushed firms to exploit it."

Although the relative importance of the state and the market in accounting for East Asia's success remains in dispute, what is clear is that the experience of the East Asian NICs was vastly different from the experience of Latin America and sub-Saharan Africa. East Asian governments adopted development strategies that emphasized exports rather than the domestic market, and they realized substantial improvements in per capita income. The development strategies adopted by governments in other developing countries emphasized the domestic market over exports and generated economic imbalances and modest improvements in per capita incomes. Consequently, when economic crises forced governments to adopt reforms, the East Asian example provided a powerful guide for the kind of reforms that would be implemented.

A Closer Look

Economic Reform in China

China's emergence as a global economic power has also been driven by dramatic market reforms. China has followed a distinct path to the global market, however, because it embarked on the journey as a

centrally planned economy: all economic activity was conducted by state-owned enterprises in line with targets established by the Communist Party's central plan. China's move to a market economy has followed a strategy of "gradualism" in which it sought to "grow out of the planned economy" (Naughton 1995). Rather than quickly replacing the centrally planned economy with a market economy. China maintained the planned economy while simultaneously encouraging market-based activities. As China's market economy grew, the relative importance of the planned economy shrank. During the last 25 years, therefore, a market economy gradually emerged in place of the previous state-centered economy.

China based reform on three pillars. The first pillar, implemented in the late 1970s, brought market incentives to agricultural production. This Household Responsibility System encouraged farmers to lease land from their agricultural commune. The government required farmers that took advantage of this opportunity to sell some of their crop to the state at state-set prices. They could sell the remainder at market prices and retain the resulting profits. The Chinese government also changed state-set prices to more accurately reflect the supply of and demand for agricultural commodities. In doing so they encouraged farmers to respond to market prices rather than state production targets. By most accounts, the reform was a dramatic success, raising agricultural productivity and farm incomes sharply during the 1980s (Pyle 1997, 10). Agricultural reform also released labor from the Chinese countryside. Consequently, China has experienced substantial rural-to-urban migration of about 10 million people each year.

The second reform pillar, introduced in 1984, brought market incentives to manufacturing. This Enterprise Responsibility System encouraged enterprises to manage themselves like profit-oriented firms. Enterprises were increasingly required to acquire their inputs from and to sell their output in markets at market-determined prices rather than through state agencies at state-set prices. The government reduced production subsidies and required enterprises to turn to banks for working capital. This withdrawal of state financial support forced enterprises to care about profitability. Over time, private contracts based on market prices replaced state-determined targets as the basis for production (Jefferson and Rawski 2001, 247). By 1996, about 9.4 million non-state enterprises were operating in the Chinese economy, accounting for about 75 percent of total industrial output (Shen 2000, 148). Here we clearly see China growing out of the planned economy

—each year a larger share of total output is produced by non-state enterprises and a smaller share by the state-owned sector.

The third pillar of reform, the open-door policy, opened China to the global economy by liberalizing foreign direct investment and trade. The government attracted foreign investment by creating Special Economic Zones along China's southern coast. Special Economic Zones (SEZs) allowed more market-based activity than was permitted in the rest of the economy. Tariffs were reduced, labor market restrictions were relaxed, private ownership was allowed, and taxes were reduced in the SEZs. The SEZs thus provided useful "reform laboratories" in which officials could experiment before implementing reforms throughout the country (Shen 2000; Grub and Lin 1991). The decision to locate the SEZs along the southern coast reflected the desire to attract investment by Chinese nationals living abroad. The SEZs in Guangdong province bordered Hong Kong, for example, whereas the SEZ established in Fujian Province faced Taiwan. The policy was extended to the entire coastal region and selectively extended into the interior in 1988. The government also liberalized trade. It expanded the number of companies allowed to conduct foreign trade from 12 to more than 35,000 (Lardy 2002, 41). The government also reduced trade barriers, first shifting from a quota-based to a tariff-based system and then reducing tariffs sharply to the current average rate of 15 percent. In December 2002, China joined the WTO after almost 15 years of negotiations.

These reforms have transformed China from a sleeping dragon into a powerful force in the global economy. China has grown more rapidly than almost all other economies since the early 1980s, with the best estimates suggesting annual growth rates of 6 to 10 percent since the early 1980s. Such rapid growth has raised per capita incomes, which doubled between 1979 and 1990 and then doubled again during the 1990s. Rising incomes have in turn reduced poverty. According to the World Bank, the share of China's population living in extreme poverty fell from 53 percent in 1981 to just 1.9 percent by 2017 (World Bank 2006, 2017c). China has also emerged as an important player in the global economy. It is currently the leading recipient of foreign direct investment in the developing world, and now hosts one-third of all FDI based in the developing world. China's share of world trade has grown from less than 1 percent in the 1970s to 17 percent today (Lardy 2002, 55; WTO 2017). As a consequence, China is now the world's largest exporter of merchandise (WTO 2017).

China's transformation is not yet complete. The state-owned sector remains an important component of China's economy that requires reform. The state-owned sector is composed of a relatively small number (only 106) of very large firms (47 of these firms are among Fortune Magazine's 500 largest firms in the world). But together these enterprises account for between one-quarter and one-third of China's total output (Leutert 2016). These very large enterprises are (on average) inefficient and require substantial reform. It remains to be seen whether the Chinese government can effectively consolidate these enterprises, or encourage them to operate more efficiently. In late 2015, the Chinese government launched a new reform initiative. In addition, rapid growth has widened the income gap between urban and rural regions, as industrial incomes rise more rapidly than agricultural incomes. In fact, farm incomes have even fallen a bit over the last 5 years. Rising inequality has sparked rural protests, which have been met with rather brutal government responses. Thus, China's government continues to face substantial challenges as it transforms its economy.

STRUCTURAL ADJUSTMENT AND THE POLITICS OF REFORM

By the early 1980s, governments in many developing countries were recognizing the need for reform. The imbalances generated by ISI created pressure for reform, and East Asia's success provided an attractive alternative model. It took a massive economic crisis, however, for governments to implement reform. We will examine this crisis in detail in [Chapter 14](#); here, we say a few words about it in order to understand how it produced the wave of reform that swept the developing world during the 1980s.

Economic crises struck developing countries during the early 1980s in large part as a consequence of governments' decision to borrow to finance their budget and current-account deficits. Using foreign loans to finance budget and current-account deficits is not an inherently poor choice. But two factors made this decision a particularly bad one for developing countries in the 1970s. First, many of the funds that governments borrowed were used to pay for large infrastructure projects or domestic consumption, neither of which generated the export revenues needed to repay the loans. As a result, the amount that developing countries owed to

foreign lenders rose, but the countries' ability to repay the debt did not.

Second, between 1973 and 1982, developing countries were buffeted by three international shocks: an increase in the price of oil, a reduction in the terms of trade between primary commodities and manufactured goods, and higher interest rates on the foreign debt those countries had accumulated. These shocks increased the amount of foreign debt that developing countries owed to foreign banks, raised the cost of paying that debt, and greatly reduced export earnings. By the early 1980s, a number of developing countries were unable to make the scheduled payments on their foreign debt.

As crisis hit, governments turned to the IMF and the World Bank for financial assistance. The international institutions linked financial assistance to economic reform. The World Bank and the IMF encouraged governments to adopt such reforms under the banner of **structural adjustment programs**—policy reforms designed to reduce the role of the state and to increase the role of the market in the economy. The specific content of the reforms that the IMF and the World Bank advocated were shaped by their belief that East Asia's success had resulted from export-oriented and market-based development strategies (see World Bank 1991, 1993). In the World Bank's own words,

the approach to development that seems to have worked most reliably, and which seems to offer most promise, suggests a reappraisal of the respective roles for the market and the state. Put simply, governments need to do less in those areas where markets work, or can be made to work, reasonably well.

(World Bank 1991, 9)

To this end, structural adjustment emphasized changing those aspects of developing economies that were most unlike conditions in Asia. Governments were encouraged to create a stable macroeconomic environment, to liberalize trade, and to privatize state-owned enterprises (Williamson 1990, 1994). Macroeconomic stability was to be achieved by transforming government budget deficits into budget surpluses. Governments were encouraged to liberalize imports by dismantling import-licensing systems, shifting from quota-based forms of protection to tariffs, simplifying complex tariff structures, and reducing tariffs and opening their economies to imports.

The IMF and the World Bank also encouraged privatization of state-owned enterprises—that is, selling such enterprises to private individuals and groups. The IMF and the World Bank argued that reducing government involvement in the economy would foster competition and

that greater competition would in turn help create a more efficient private sector that could drive economic development. Through structural adjustment, therefore, governments were encouraged to scale back the role of the state in economic development and to enhance the role played by the market.

Many governments implemented structural adjustment programs between 1983 and 1995 (see [Table 7.4](#)). They began to liberalize trade in the mid-1980s. In Latin America, average tariffs fell from 41.6 percent prior to the crisis to 13.7 percent by 1990 (Inter-American Development Bank 1997, 42). They began to privatize state-owned enterprises in the late 1980s. In Latin America, “more than 2,000 publicly owned firms, including public utilities, banks, and insurance companies, highways, ports, airlines, and retail shops, were privatized” between 1985 and 1992 (Edwards 1995, 170; see also Corbo 2000). They liberalized investment regimes, thus opening to multinational corporations. They deregulated industries and reduced government intervention in the financial system.

Structural adjustment programs had a dramatic impact on average incomes in the short run and the distribution of income in the long run. The crisis and the reforms brought about a sharp contraction of economic activity. Income fell sharply as a result. In Latin America, income fell by about 8 percent between 1981 and 1984. In sub-Saharan Africa, incomes fell, on average, by about 1.2 percent per year throughout the 1980s (Thorp 1999, 220; World Bank 1993). The dismantling of ISI also redistributed income from urban import-competing sectors to agriculture and emerging export-oriented manufacturing industries. In The Gambia, for instance, structural adjustment tripled the prices farmers received for groundnuts and significantly increased prices that urban residents paid for petroleum products, public transportation, water, electricity, and telecommunications (Jabara 1994, 309). Privatization and civil-service reform resulted in large job losses. In Guinea, for example, the civil service was reduced in size from 104,000 in 1985 to 71,000 in 1989 (Arulpragasam and Sahn 1994, 91). In pursuing structural adjustment, therefore, governments redistributed income: export-oriented producers benefited these policies, whereas people employed in the import-competing and nontraded-goods sectors saw their incomes fall.

TABLE 7.4

Countries Adopting Trade and Domestic Policy Reforms, 1980–1996

Africa		Latin America	
Benin	Malawi	Argentina	Honduras
Burkina Faso	Mali	Bahamas	Mexico
Burundi	Mauritania	Barbados	Nicaragua
Cameroon	Mauritius	Belize	Panama
Central African Republic	Mozambique	Bolivia	Paraguay
Chad	Niger	Brazil	Peru
Congo	Nigeria	Chile	Suriname
Cote d'Ivoire	Rwanda	Colombia	Trinidad
Ethiopia	Senegal	Costa Rica	Uruguay
Gabon	Sierra Leone	Dominican Republic	Venezuela
The Gambia	Tanzania	Ecuador	
Ghana	Togo	El Salvador	
Guinea	Uganda	Guatemala	
Guinea-Bissau	Zambia	Guyana	
Kenya	Zimbabwe	Haiti	
Madagascar			

Sources: World Bank 1994a; Thorp 1999.

The economic consequences of structural adjustment drove the domestic politics of reform (see Nelson 1990; Remmer 1986; Haggard and Kaufman 1992; Oatley 2004). Groups that would lose from structural adjustment attempted to block the reforms, whereas those who stood to gain attempted to promote reform. Governments were forced to mediate between them, and in many countries governments were heavily dependent upon political support from the import-competing and nontraded-goods sectors. Thus, reforms were hard to implement. Over time, however, the economic crisis triggered a realignment of interests, discrediting groups associated with the old policies and giving greater influence to groups that proposed an alternative approach (Krueger 1993a). By weakening key interest groups and by forcing many to redefine their interests, the crisis gradually eroded many of the political obstacles to far-reaching reform. Yet, this process took time, as reforms could be implemented only after new governments responsive to new interests had replaced the governments that presided over ISI.

GETTING INSTITUTIONS RIGHT

As the 1990s progressed, members of the development community began to argue that “getting prices right” by using SAPs to liberalize and marketize developing economies, while perhaps a necessary step toward sustained development, was not sufficient to deliver sustained growth. As a consequence, policymakers and academics began to focus greater attention on the broader context within which states made policy. As attention shifted away from the rather exclusive focus on policy reform, the characteristics and quality of political and economic institutions moved to the center. By the turn of the century there was “widespread agreement among economists studying economic growth that institutional quality holds the key to prevailing patterns of prosperity around the world” (Rodrik 2004, 1).

Thinking about institutions led to the articulation of two broad institutional configurations—inclusive institutions and extractive institutions—that have very different consequences for economic performance (Acemoglu and Robinson 2012). **Inclusive institutions** have political and economic characteristics that encourage individual initiative and sustained economic growth. The most important political characteristics of inclusive institutions include the broad extension of the right to select and constrain governments, adherence to the rule of law and a strong but (by virtue of the rule of law) constrained state. Among the relevant economic characteristics, inclusive institutions have strong property rights and market structures that reward individual talent. Inclusive institutions are likely to provide high-quality public services that are important to growth, such as public education that is available to all and infrastructure investments that facilitate market development. The elaboration of property rights and their defense in the rule of law system encourages investment in productivity-improving activities. The fact that the opportunities for economic activity are open to the broad public rather than restricted to the chosen few creates incentives for individual initiative. Inclusive institutions are thus likely to generate economic growth that is sustained over time.

Extractive institutions, by contrast, lack most of these redeeming qualities. In terms of politics, extractive institutions allocate power very narrowly to a small ruling elite and systematically exclude other segments of society from access to power. In addition, the elite’s power is relatively unconstrained by electoral institutions or by a clear rule-of-law-based judicial system. Economic institutions also do little to reward the initiative

of individuals. Property rights are often lacking, or where present are unevenly enforced. In such systems, the elite use their power to extract income from those who are excluded from politics and use it to provide benefits to the narrow group that rules or to the subset of society that keeps the government in power. Such systems become characterized by corruption within the state and among the ruling elite, and by rent seeking at the level of the society as a whole. As a consequence, the balance between productive and unproductive activity tips in a direction unfavorable to sustained economic growth.

One might illustrate the importance to economic performance of these institutional differences relative to other possible factors by comparing societies that share common cultures and geographies but have very different institutional characteristics. Consider North Korea and South Korea as one such comparison. South Korea has experienced sustained growth rates and dramatic improvements in the standard of living. North Korea, in contrast, has experienced exceptionally poor economic performance, even to the point of suffering widespread food scarcity. Acemoglu and Robinson's institutional perspective attributes these different economic trajectories to different institutions. They argue that the two countries occupy basically the same geographic space (the Korean peninsula), and thus confront the same climate and geographical constraints and opportunities. The two Koreas share a common language and culture, and (at least through 1940) they had a common history. The two differ primarily in their institutional characteristics, with South Korea benefiting from inclusive institutions and North Korean performance undermined by its extractive institutions. Acemoglu and Robinson offer other comparisons that are similar in nature, such as East and West Germany during and after the Cold War. Perhaps you can think of other comparative cases that either support or confound their institutional hypothesis.

Although the Acemoglu and Robinson institutional hypothesis holds considerable appeal, at least two important questions about the approach have been posed by its critics. The first critique points to potential issues of reverse causality. What we mean by reverse causality is the possibility that economic development outcomes are the underlying cause of institutional configurations rather than the Acemoglu and Robinson hypothesis that institutions cause development outcomes. Concerns about reverse causality arise from a large body of research that had been conducted prior to the more recent work by Acemoglu and Robinson. Indeed, almost 60 years ago Seymour Martin Lipset hypothesized that

economic development causes democratization: “the more well-to-do a nation, the greater the chances that it will sustain democracy” (Lipset 1959, 75). Subsequent empirical scholarship has found substantial support for the Lipset hypothesis (Boix 2011; Barro 1996; Przeworski et al. 2000). Indeed, as one highly influential recent study concluded, “the level of economic development, as measured by per capita income, is by far the best predictor of [democratization]” (Przeworski et al. 2000, 88).

The second critique concerns the origins of political institutions. If, as Acemoglu and Robinson claim, different institutional configurations generate different development outcomes, it becomes important to understand what accounts for cross-national variation in institutions. That is, why are some societies fortunate enough to have been endowed with inclusive institutions that promote development while other societies have had the misfortune to be burdened with extractive institutions that do not promote development? Acemoglu and Robinson (2001) have argued that institutions reflected colonial settlement patterns. Where colonial mortality was high, due to climate and disease, colonists did not expect to establish permanent residence. They thus created extractive institutions that maximized their short-run take. Where colonial mortality rates were low, colonists were more likely to establish permanent settlements and thus were more likely to create inclusive institutions that promoted economic development. And these distinct institutions persisted after colonialism ended. For A&R, therefore, contemporary institutions—and thus development outcomes—are reflect developments that occurred hundreds of years ago and continue to exert influence through the social processes that make it very difficult to change institutions. One potential problem with this argument is that it is difficult to isolate the causal significance of institutions from the impact of climate and geography (see Diamond 2012).

Other scholars also have explained institutions by focusing on the interaction between colonialism and resource endowments. Engerman and Sokoloff (2000) focus their attention on explaining divergent development outcomes in South and North America and the Caribbean. They argue that low-quality institutions—essentially the equivalent of extractive institutions—emerged in colonies in which land, climate, and labor endowments encouraged colonists to engage in plantation-based agriculture. On Caribbean islands, for instance, the climate and land were conducive to sugar production, while small indigenous populations forced the colonial powers to rely upon imported slave labor. Colonists built political institutions that enabled them to control sugar production and

income and to exclude slaves from participation in politics. The result was high inequality and low political inclusiveness. In contrast, in the northern parts of North America, climatic conditions and land endowments encouraged grain farming organized as small-holdings that relied on family labor rather than slaves. This small holding model generated less economic inequality which carried over into the design of political institutions which were more inclusive. In short, the interaction between geography and colonialism led to the establishment of particular institutional arrangements 250 and more years ago, and these institutions have exerted a powerful influence on development trajectories ever since.

The continued uncertainty about the origins or causes of institutions has important implications. Because different institutions are associated with different development outcomes, a central determinant of success lies in getting institutions right. Yet, this implies that societies stuck with extractive institutions can escape only if they can create more inclusive institutions. But if societies can change from extractive to inclusive institutions at will, then institutions aren't exogenous to state policy—they haven't really been inherited from 200 years ago—and cannot have the substantial independent impact on economic development that institutionalists claim.

Policy Analysis and Debate

Shifting from the Washington to the Beijing Consensus?

Question

Should the “Washington Consensus” be replaced by the “Beijing Consensus” as a development model?

Overview

The 1980s were turbulent for the developing world. The decade began with sovereign debt crises in several Latin American countries, and ended with the collapse of the Berlin Wall and political and market reforms in Eastern Europe. Responding to these events, economist John Williamson identified the “Washington Consensus” on the policies that developing countries must implement to ensure a return to growth. Williamson called this package the Washington Consensus because the World Bank, IMF, and U.S. Treasury Department—all based in Washington D.C.—concurred with these policy

recommendations. Key to the Consensus was eliminating government involvement in the economy: “stabilize, privatize, and liberalize.”

The recent success of China and other East Asian countries as well as what some characterize as disappointing achievements from the Washington Consensus, have led some to suggest that a so-called “Beijing Consensus” is replacing or should replace the Washington Consensus. If the “Washington Consensus” espoused decentralized market fundamentalism, then the “Beijing Consensus” advocates a return to a state-led development strategy. This new development path appeals to many governments for two reasons: first, it promises rapid results without a loss of sovereignty to Western governments that many developing country governments saw as a major part of the Washington Consensus. Second, it increases the government’s power within the country by creating a justification for state intervention and allocation. Advocates for the Beijing Consensus emphasize its potential for delivering rapid development. Critics ask why governments would be expected to have better success with a state-led strategy now than they experienced under ISI.

Policy Options

- Washington-based institutions should continue to promote neoliberal politics. If governments do not comply, Washington-based institutions should withhold aid and consider trade sanctions.
- Governments should be allowed to pursue development as they see fit, and development aid and trade relations should not be contingent upon the adoption of any particular policy orientation.

Policy Analysis

- What differences do you see between the Washington Consensus and the Beijing Consensus? What about between the Beijing Consensus and the ISI strategy?
- What interest, if any, does the United States have in promoting neoliberal reforms like those of the “Washington Consensus”? Why might the United States oppose diffusion of a state-led strategy?
- Why might developing countries resist neoliberal development programs and favor a more state-centric model?

Take A Position

- Should the United States pressure developing countries to pursue neoliberal policies? Should developing countries resist? Justify your answer.
- What criticisms of your position should you anticipate? How would you defend your recommendations against these criticisms?

Resources

Online: Do online searches for “Washington Consensus” and “Beijing Consensus.” You might begin with a speech given by John Williamson titled “Did the Washington Consensus Fail?” (located at www.iie.com/publications/papers/paper.cfm?ResearchID=488). Kenneth Rogoff, former head of the IMF, wrote an open letter to Joseph Stiglitz in response to criticisms of IMF neoliberal policies (located at www.imf.org/external/np/vc/2002/070202.HTM). One influential criticism of the “Washington Consensus” is Dani Rodrik, “Goodbye Washington Consensus, Hello Washington Confusion?” (located at [www.hks.harvard.edu/fs/drodrik/Research%20papers/Lessons%20of%](http://www.hks.harvard.edu/fs/drodrik/Research%20papers/Lessons%20of%20the%20Washington%20Consensus)

In Print: There are many lengthy criticisms of the “Washington Consensus”, the best-known of which may be Joseph Stiglitz, *Globalization and Its Discontents* (New York, NY: W.W. Norton & Co., 2002), which prompted Rogoff’s reply (linked above).

CONCLUSION

Neoliberalism supplanted structuralism as the guiding philosophy of economic development as a result of the interplay among three factors in the global economy. Import substitution generated severe economic imbalances that created pressure for reform of some type. The success of East Asian countries that adopted an export-oriented development strategy provided an alternative model for development. Finally, the emergence of a severe economic crisis in the early 1980s, a crisis that resulted in part from the imbalances generated by ISI and in part from developments in the global economy, pushed governments to launch reforms under the supervision of the IMF and the World Bank. By the mid-1980s, most governments were implementing reforms that reduced the role of the state

and increased the role of the market in economic development.

The implementation of these reforms has been neither quick nor painless. The depth of the reforms brought substantial short-run costs as average incomes fell and as this smaller income was redistributed among groups. The proponents of neoliberal reforms argue that the short-run costs are worth paying, however, for they establish the framework for strong and sustainable growth far into the future. Achieving that outcome will require developing societies to consolidate and build upon the reforms already implemented. In addition, it will require the advanced industrialized countries to accept short-run adjustment costs of their own in order to meet the legitimate demands that developing countries now make about market access.

The adoption of neoliberal reforms in the developing world is also transforming the global economy. For the first time since the early twentieth century, the developing world has integrated itself into that economy. In doing so, developing countries have altered the dynamics of global economic exchange. Standard trade theory tells us to expect trade between capital-abundant and labor-abundant societies. Yet, trade barriers have greatly limited such trade for most of the postwar era. As these barriers have fallen during the last 20 years, trade between countries with different factor endowments has become increasingly important. Businesses are increasingly locating their activities in those parts of the world where they can be performed most efficiently. Labor-intensive aspects of production are being shifted to developing societies, whereas the capital-intensive aspects of production remain in the advanced industrialized countries. The expansion of North–South trade is thus creating a new global division of labor.

KEY TERMS

Current Account
East Asian Model of Development
Export-Oriented Strategy
Extractive Institutions
Inclusive Institutions
Rent Seeking
Structural Adjustment Program

SUGGESTIONS FOR FURTHER READING

On the East Asian Model of Development, see Robert Wade, *Governing the*

Market: Economic Theory and the Role of Government in East Asian Industrialization (Princeton: Princeton University Press, 2003), Yin-wah Chu (editor) *The Asian Developmental State: Reexaminations and New Departures* (London: Palgrave MacMillan, 2016), and Dani Rodrik, *One Economics, Many Recipes: Globalization, Institutions, and Economic Growth* (Princeton: Princeton University Press, 2008).

The single best account of China's trajectory is Barry Naughton, *The Chinese Economy: Adaptation and Growth* (Cambridge: MIT Press, 2018).

For a detailed examination of the relationship between institutions and development, see Daron Acemoglu and James Robinson, *Why Nations Fail: The Origins of Power, Prosperity and Poverty* (New York: Crown Business, 2013).

For an application of the institutionalist perspective to contemporary sub-Saharan Africa, see Robert H Bates and Steven Block, 2017. "Political Institutions and Economic Growth in Africa's 'Renaissance.'" *Oxford Economic Papers*, 1–26.