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For Robert and Sophia; and for Davis and Felix

will proceed. This is a transitional period of tremendous uncertainty, especially for countries that have not participated as actively in setting the dominant rules of the game in the world political economy, and there are always challenges to studying an unfolding phenomenon. Japan may be moving toward a post-developmental state and China is becoming a post-socialist state just as both of their prior developmental strategies appear to have become less relevant to enhancing their national economic well-being in the global political economy. Even though the definitional endpoints of liberalization are reasonably transparent on paper, the following chapters demonstrate the political and institutional complexity of this process across different sectors. For these reasons, it is premature to declare the victory of liberalizing outcomes in practice, and important to recognize the relevance of adaptive state and societal processes.

Notes

1 Figures calculated from *World Trade Organization Annual Report 2004*, 37, Table III.1. Given their historical adversarial relationship, we do not suggest that these economic figures translate into corresponding political might.
2 On China, see White (1988), Oi (1992), and Zweig (2002).
3 Indeed, one of the well-known dependency theorists, Peter Evans, contributed substantially to the developmental state literature (Evans 1989, 1995).
4 Please note that we are neither making the broader normative claim that liberalization is desirable nor proposing that liberalization is teleologically inevitable. Instead, the volume is inspired by the political economic reality that strong international pressures for liberalization exist at this point in history.
5 Friedman (1999: 83–92) colloquially refers to this as the "golden straitjacket."
6 Wade makes this point nicely in Berger and Dore (1996: 60–88).
7 We acknowledge, of course, that OECD countries exhibit tremendous variation in terms of their degree of public–private cooperation, provision of social welfare services, etc. (P. A. Hall and Soskice 2001).
8 Of course, Japan was active in the world trading system prior to 1989, but we are interested in specifying the more recent critical juncture that pushed it on to a path of deeper reforms (see Wood 1992).
9 For a regional perspective on reactions to the crisis, see Pempel (1999a).

Revisiting the Japanese economic model

T. J. Pempel

Why revisit the Japanese economic model? Have events not proven it to be intellectually flawed as well as politically and economically irrelevant? During the late 1980s and early 1990s, airport bookstalls bulged with countless titles breathlessly promising to disclose "the secrets behind the Japanese economic miracle" or predicting that the twenty-first century would belong to Japan (or Asia). Policy-makers across Europe and North America trembled nervously in anticipation of an inevitable "Japanese takeover." Then suddenly, Japan was mired in the swampy after-effects of a classic asset bubble, which, after it burst in 1991, left the country mired in over a decade of unprecedented slump: gross national product (GNP) growth was the lowest in the OECD; the yen was 50 percent below its 1995 high; the financial sector faced non-performing loans four to six times greater than those that confronted the United States during its savings and loan crisis of the 1980s; unemployment catapulted to the highest levels since the years immediately following World War II; and public sector debt as a percentage of GNP was the highest in the industrial world while the Nikkei index hit a sixteen-year low. Asia's former behemoth had become a limping Lilliputian.

Meanwhile, as the editors to this volume stress in the first chapter, liberalization gained prominence as the prevailing economic ideology across wide stretches of the world. This was a result, among other things, of the resurgence of the US economy, the growing power of venture capital and information technology, the political decline of the left in Europe, the rapid economic development of China following the at least partial embrace of neo-liberal criteria for foreign direct investment, as well as the ability of the United States and the International Monetary Fund (IMF) to impose neo-liberal conditionality on much of developing Asia during the regional crisis of 1997–98. At the turn of the century it was the People's Republic of China (PRC), far more than Japan, that was attracting the attention of policy-makers, business leaders and investors worldwide. Under such conditions, why devote serious attention to a Japanese "model" that seems obviously to have been a limited, if not disastrous, prescription for economic improvement?

This chapter suggests that there is still a need to assess and understand the Japanese economic model. It argues that, despite the subsequent difficulties faced by the national economy of Japan, the developmental state model that was generated to explain its earlier successes (as well as those of South Korea and Taiwan at a minimum) is worthy of retention, albeit with some reassessment. Indeed, as will be argued below, many of Japan's current economic problems arise from the difficulties associated with disestablishing the institutions and policies created under the earlier model of developmentalism and which have become problematic in a world dominated by economic liberalization. Only by examining the Japanese economy in both its blooming and its fallow periods can the complexity of factors critical to both phases become clear. Any useful model of Japanese development must be able to identify not only the causes of rapid growth, but also those of subsequent slowdown.

Two additional reasons for such an investigation stand out. First, despite any subsequent economic problems that arose, the Japanese success story remains marked by vastly more sophisticated engines of production, and its citizens benefit from immensely higher standards of living, than is the case in countries to which Japan was comparable three or four decades earlier. Whether it does so successfully, strategically, or unwillingly, as discussed in the other Japan chapters to this volume, the fact is that Japan at the beginning of the twenty-first century is far better poised economically to deal with the new-world paradigm of liberalization than it was in the 1950s or 1970s. Nor should one discount the importance of Japanese economic success for the rest of Asia, many of whose governments explicitly sought to emulate Japanese developmental patterns. During the last quarter-century, among all the world's major regions, only Asia has achieved a substantial increase in the share of world GNP and world incomes enjoyed by its populations. Current downturns should not obscure the longer-term economic restructurings that took place across Asia during the 1980s and 1990s and the permanent gains these generated, nor the enhanced abilities of economies across the rest of Asia to adjust to new-world conditions from positions of economic strength.

Second, despite the recent triumphalism of neo-liberal economists, the economic problems faced by Japan and other parts of Northeast Asia provide little convincing evidence of any inherent flaws in their approaches to growth. Japanese troubles do not, as is too often contended, provide incontrovertible evidence that certain allegedly underlying principles of "market economics" transcend geography and admit of no long-lasting exceptions. Neither Japan nor Asia generally should serve as a warning to others about the dangers of trying to flout Adam Smith and of interfering with "free markets" in capital flows and the production of goods. If Japan, like other countries of the world, must now adjust to the prevailing economic paradigm of liberalization, it is highly unlikely to adjust through blind emulation. Rather, again as the individual chapters by Pekkanen, Solis, Katada, and Anchordoguy show, the adaptation of Japan's future economic mix is almost certain to involve residues of "developmentalism" onto which will come new graftings of neo-liberalism. Just as earlier decades of Japanese success were not easily explained through neo-classical economics, so too the recent problems by themselves say little about the relative strengths or weaknesses of the discipline of economics or of the inevitability of worldwide liberalization. Rather,

the mix of Japan's successes plus downturns sheds valuable light not only on the limitations endemic to early theorizing about the sources of Japanese growth but on that model's inherent promises as well. And many of the pluses endemic in developmentalism are likely to survive any onslaught of liberalization.

This chapter is organized into three main sections. The first recapitulates what I see as the major components of the various Japanese developmental models. The second then examines how several of these components contributed to subsequent economic problems faced by Japan, as well as many of the other East Asian national economies. Finally, a third section suggests lessons that might be culled from the combination of successes and limitations of the models of Japanese development, especially as calls for liberalization continue unabated worldwide.

Key components of Japanese development models

One of the great puzzles of comparative political economy concerns how nation-states can improve both their relative and their absolute well-being. How do national economies that are relatively underdeveloped at one point in time "catch up" to those that are more advanced? For the most part, they have not. Since the 1960s, for example, the relative share of world GNP held by the richest 20 percent of the world's population has increased dramatically while that accounted for by the bottom 20 percent has shrunk. The ratio was 30:1 in 1960, 45:1 in 1985, and more than 60:1 by the turn of the century (Frieden and Lake 1995: 417).

A host of rather pessimistic scholarship has developed around world systems theory and dependency theory, arguing to varying degrees that the relative international pecking order remains essentially fixed over time. Yet, Asia carried out a striking collective break-out from that pattern. In 1960, Japan and the rest of Asia accounted for about 5 percent of world GNP compared with 37 percent for North America. By the early 1990s, they accounted for roughly 30 percent of world GNP, about the same share as North America and Western Europe. The early leaders of Asia's development were Japan, South Korea, and Taiwan, followed later by several successes in Southeast Asia and eventually Greater China. Collectively, Asian development makes it clear that one need not accept as permanent any relative division of economic power. Not only is catch-up possible in the abstract, it has been demonstrated across Asia as a historical reality.

Over the post-war period the national economies of Japan, and then later South Korea and Taiwan, using similar models of development, moved substantially ahead of those in countries that initially enjoyed higher GNPs and better standards of living. Japan's GNP grew at rates double those of the other OECD countries from the early 1950s until the beginning of the 1990s. Its share of world exports quadrupled, and it went from the twentieth to the second largest economy in the world. For fully four decades Taiwan's GNP grew at an average of 8.7 percent per year; exports expanded at 20 percent per year; and the industrial share of production increased from 25 percent to 45 percent (T.-J. Cheng 1989). Korea's growth was slower to start, but over the approximately thirty-year period 1961–91 it rose by 8.4 percent per year. By 1997, as noted, it ranked ninth in world GNP and had been welcomed into the OECD as a member of the industrialized bloc. Both countries roared past others that were once their economic peers. To be sure, all three countries provided excellent examples that any division of world economic power is more variable than constant. A country "down" at one point in time could look to the countries of Northeast Asia during the post-war period and see proof that moving "up" was not impossible.

Virtually all studies of Japan agree that economic development is possible, both absolutely and relatively. Yet not all agree on the causes or the replicability of the Japanese model. Individual studies differ on the particular contribution of Asian culture or values, for example, to macroeconomic growth and industrial transformation.[1] Yet regardless of specifics, studies of Japanese (and Asian) development long provided a broadly optimistic picture for countries facing the arduous uphill trek of economic development. The Japanese developmental experience appeared to offer a welcome example of successful climbs.

A second important commonality – though not always as vigorously stressed – is the extent to which Japanese (and Northeast Asian) growth was achieved in tandem with relatively high levels of social equality. This commitment to social equality came about despite the fact that none of the East Asian success stories had left of center or socialist governments, elements typically associated with low levels of social inequality. Thus, Japan long enjoyed a Gini Index similar to that of Sweden or Norway, rather than to more conservative countries such as Canada, the UK, the United States, or West Germany.[2] And, in contrast to Latin American countries such as Brazil and Argentina with Gini Index figures around 0.60, Taiwan's was always low and falling, with a figure of just below 0.30. South Korea's has generally been in the range of 0.33–0.35 since the mid-1960s.[3] In addition to having relatively small gaps between rich and poor in terms of wealth and life expectancy, the nation-states of East Asia also provided relatively equal access to health care and education. Furthermore, although far from gender neutral, they were far more equal than many parts of the world in the provision of educational and health care opportunities to females. Such a commitment built up broad support from a variety of diverse constituencies and created commitments to broad segments of society in ways that the harsher versions of liberalization and market capitalism did not. This is especially critical in the period characterized as late liberalization by the editors. As a consequence, electoral politics was rarely fought over sweeping class and distributional issues such as prevailed in North America or most of Western Europe, but more frequently over the particular compensations paid out to a wide range of diverse and segmented constituencies.

In this regard, too, the comparative picture for students of development is far more sanguine than that proposed by world systems theorists or dependencistas. East Asia appeared to offer a mixture of high growth with social equality, thus undercutting any claims that the two were incompatible. East Asia, developmentalists argued, demonstrated, quite to the contrary, that the two not only were mutually achievable, but might indeed be mutually interdependent.

Two major models have dominated discussions of Japanese development. These represent the classic dichotomy between "states" and "markets." The first is highly political; the second is economic. They share the view that nations can achieve significant improvements in their economies without the wide disparities between rich and poor found in so many developing countries. Despite such agreement, however, the two models identify quite different causes for Japanese advances, reflecting the very different approaches to political economy taken by political scientists and economists.

The first model concentrates primarily on the steering role played by a highly meritocratic national bureaucracy. By far the best known of these is that of Chalmers Johnson, articulated first in his 1982 volume, *MITI and the Japanese Miracle*. Johnson's argument centers on the concept of the "developmental state," and his notion is reflected in many other studies.[4] Japan and the other Northeast Asian states, such studies typically argue, have been successful because governments there work consistently on behalf of catch-up economic growth. In contrast to so many other parts of the world, political institutions in Japan, it is argued, particularly the national bureaucracy, acquired control over a variety of tools presumed critical to economic success: they can extract capital, generate and implement national economic plans, manipulate private access to scarce resources, coordinate the efforts of individual businesses, target specific industrial projects using specific criteria for selection, resist political pressures from popular forces such as consumers and organized labor, insulate their domestic economies from extensive foreign capital penetration, and, most especially, carry through a sustained project of ever-improving productivity, technological sophistication and increasing world market shares. Initially and most forcefully articulated with specific reference to Japan, the developmental state model has also been widely applied to South Korea and Taiwan.

This state-centric political model concentrates attention on several valuable elements, which again need to be center stage in debates over late liberalization. First, authors stressing one or another variant of the "developmental state" typically give primacy to the importance of political choice in the setting of economic priorities and in creating economic institutions. Markets, such authors assume, operate neither in political vacuums nor as "invisible hands." Rather, they function within specific boundaries set for them by the politically powerful. State officials, in particular senior bureaucrats, are seen to be critical to the structuring of political choices and public policies conducive to growth. As such, these models start with a presumption that the key to understanding economic development is a national government exercising state power, rather than an unstructured mass of economic maximizers. Indeed, in one of the most explicitly anti-market aphorisms to emerge from the developmental state literature, Alice Amsden (1989) argues that the South Korean economy did so well precisely because government officials "deliberately got prices wrong."

In addition, state-centric models focus heavily on the importance of government-directed industrial policies that transfer resources to increasingly higher value-added sectors of the economy. Thus, investments and production move from bicycles to motorcycles to cars, and from radios to televisions to computers. Even more importantly, such industrial policies are explicitly linked to the production of internationally competitive goods, making for a development strategy based on export-led growth rather than import substitution.

A final element that demands attention is openness or closedness to the outside world, which is critical for debates over liberalization. While individual studies differ on specifics, most developmental state research underscores the extent to which development operates as a zero-sum, us-against-them, national project of "catch-up." Governments act to enhance their interpretation of the "national interest," defined almost invariably as rapid growth in the interests of domestic, rather than foreign, owners and producers. Governments and domestic businesses are presumably closely enmeshed with one another during their quest for national economic improvement. The common interests of these two are presumed to outweigh any specific disagreements they might have. Most typically, the domestic economy is kept insulated from penetration by foreign capital, products, and managers. Relatedly, while national consumers may not be ignored in the pursuit of national economic improvement, their specific interests as consumers are unquestionably secondary to those of producers. Hence, if cheaper prices for consumers require the opening of the national economy to foreign imports or products, then truly free trade and investment must be kept secondary to mercantilist protectionism. In this regard, developmental statists are frequently associated with glib clichés about "Japan, Inc." or "Korea, Inc."

In all of these ways, the developmental state model concentrates its explanatory power on how governments shape economics in ways designed to enhance the long-term national well-being of key national corporations and industries at the relative expense of other nation-states. In these ways, the developmental state is explicitly antithetical to liberalization and, given its centrality in Japan, cannot be ignored in debates over liberalization. Not surprisingly, economic models lay stresses elsewhere.

A limited number of economists studying Japanese development have put forward claims that nothing about its development need be examined beyond the standard principles of economics (e.g., Saxonhouse 1983). More frequent, however, is the argument that particular government policies contributed an important, but largely environmental, climate for the true engines of growth, namely the private sector. One of the earliest economic approaches to understanding Japan's rapid growth was the 1976 study edited by Patrick and Rosovsky entitled *Asia's New Giant: How the Japanese Economy Works* (Patrick and Rosovsky 1976: esp. 47). As a summary of their position, they stated: "Our view is that, while the [Japanese] government has certainly provided a favorable environment, the main impetus to growth has been private – business investment demand, private saving, and industrious and skilled labor operating in a market-oriented environment of relative prices." An even more recent market-focused study was the 1993 study of the World Bank entitled *The East Asian Miracle* (World Bank 1993; esp. 5, 192–6, 265–73). This book, prompted by the Japanese government as a way to encourage greater understanding among economists of the ways in which Japan and other countries in Asia had developed, actually took an approach dramatically different from that of the developmental statists. While sensitive to the possible contributions of government policies to growth, it concluded that "In large measure the HPAEs [high-performing Asian economies] achieved high growth by getting the basics right. Private domestic investment and rapidly growing human capital were the principal engines of growth."

In this context, most economic models are quick to acknowledge that directed credit may have contributed to Japan's and Asia's improvements, but largely insofar as financial markets were deepened through economic growth. Similarly, in the case of the correlation between high economic growth and such things as improved education, better health care, low population growth, and lower gender discrimination, most economic models argue or imply that the causal arrows run from the former to the latter rather than in reverse. An educated populace is thus seen less as a contributor to high growth and more as its consequence; policies designed to shape the character of the labor market are, as the World Bank puts it, given less weight in growth than are policies whereby governments "let markets work."

The two camps' claims mirror the perennial disputes between the two disciplines from which they emerge: When and how do political structures and policies shape economic choices? When and how are they instead the outgrowth of underlying economic logic? This question is as relevant to the past of Japan's economic model as it is to the future of Japan's liberalization efforts. Hindsight suggests that each set of claims contributed significant, but partial, insights into why the economy of Japan grew as quickly and with the particular character that it did. Clearly, Japan's political institutions and its prevailing policy profile set conditions under which it was possible for Japanese-owned companies to develop and thrive at home. They also encouraged rapid improvements in productivity and in the technological sophistication of products. And with domestic markets well protected and often with domestic consumers undergirding profit margins, a number of Japan's most internationally oriented companies were able to export their increasingly competitive products to global markets. It is impossible to imagine that these companies at the micro level and the Japanese economy at the macro level could have achieved the successes they did without the political structures and policies that prevailed in Japan from the early 1950s until the 1990s. At the same time, only by exploiting global market opportunities through price and product quality could so many of Japan's global companies gain market shares as rapidly as they did. Not at all incidentally, however, by guaranteeing domestic protection to potentially declining sectors, the developmental state created a constituency for economic development and reduced the potential political opposition from slow-moving or domestically based firms and sectors to the broader agenda of rapid industrialization. With a strong state commitment to giving them semiguaranteed slices of the domestic market, such constituencies had little incentive to resist the global market orientations of other government policies.

Yet, missing from most treatments of both models, yet equally important to understanding Japan's development, is the fact that many of the policies pursued in Japan were strongly "anti-market" at home, insulating numerous sectors from international competition and protecting an increasing number of global noncompetitive firms at high costs to domestic consumers. The model that led to success also built in many important but less than fully examined elements that subsequently led to its eventual stagnation, and that continue to be important elements in concerns over Japan's late liberalization. Furthermore, periods of rapid growth obscured some of these more vital components of past economic successes. Particularly after recent economic difficulties in Japan and much of the rest of Asia, it is thus critical to explore the limitations that were built into the Japanese development models and to re-examine these models from the more contemporary vantage point of liberalization.

Limitations on the Japanese economic development model

As the bloom faded from the rose of Japanese economic growth, it became increasingly clear that the various development models did little to predict the subsequent Japanese fizzle. Nevertheless, post-developmental problems in Japan and across Asia should encourage us not to discard the models completely, but rather to search for those of their elements that were undertheorized, and to examine how these in turn contributed to later economic problems.

Both of the models advanced to explain Japanese development, in my view, paid inadequate attention to two vital factors. Through time's rearview mirror, it is possible to see how certain elements rarely emphasized were in fact critical to its development during the boom years – and equally central to subsequent slowdowns and problems.

First, the models were constructed predominantly to stress domestic, rather than international, conditions. To the extent that they devoted much attention to international conditions, the presumption was that these provided arenas within which domestic national economies competed with one another for relative improvement in national well-being. Alternatively, the international context was presumed to be inherently benign or else was taken to be far less relevant than domestic actions. Without question, international conditions for the first forty years or so after the end of World War II were largely conducive to Japanese growth. However, such benevolent conditions were far from irrelevant to the successes achieved during those years. And when these conditions changed in several critical ways by the middle of the 1980s, their influence moved from benignly supportive of growth to malignly interruptive. The emphasis on the international, as the editors have suggested, has now become critical as Japan faces an external environment with overwhelming pressures for wholesale liberalization.

Second, the models, particularly as they applied to Japan, were preponderantly static. A host of demographically generated advantages were presumed to be ongoing, rather than temporary. Furthermore, domestic power balances and socioeconomic conditions were taken largely as a given and presumed to be positive contributors to economic growth. As a result, the models failed adequately to address issues of change, flexibility, and institutional stickiness. Nor did they address the ways in which demographic and economic conditions endemic to the model were almost guaranteed to change in ways that would reverse their earlier

consequences (but see Evans 1995; Haggard 1990). For both reasons, factors that contributed to rapid Japanese growth at earlier times were often the sources of problems and deterioration at subsequent stages.

Consider first the international conditions. Few if any of the developmental models focused on Japan give explicit attention to the indispensable contribution made by positive international conditions to Japanese and Northeast Asian economic development. This is highly ironic since one of the fundamental goals shared by Japan, South Korea, and Taiwan was the improvement of their economic conditions *relative to other states*. As a consequence, all three had to act with sensitivity to regional and international power balances and the opportunities these provided. Yet such external conditions are constantly in flux, at some times offering far greater opportunities for marginal or industrializing countries than at others. Economic options are highly contingent on the broader external arena, such as the pro-liberalization one today, within which any industrializing nation's leaders must operate. For all three countries during the highpoints of their post-war development, benign international conditions contributed greatly to their successes, just as the international ones today constrain their options.

Most basically, Japan, but Korea and Taiwan as well, were important components of the US strategic nexus. For most of the post-war period, the United States gave primacy to maintaining positive security and defense relations with all three as a part of America's bipolar confrontation with the Soviet Union and its allies. This necessitated a variety of actions to ensure the continued stationing of US troops in Japan and South Korea, access to ports and air facilities across the Asia-Pacific, coordination of strategy with the military forces of all three countries, and guarantees that each would remain a close US ally and avoid either becoming politically neutral in the Cold War or, even worse, falling into alignment with the camp dominated by the major communist powers – China and the Soviet Union.

During the first three to four decades following World War II, the United States treated improved economic conditions within all three countries as not only congruent with, but also critical to, the achievement of US strategic goals. To the extent that these countries did well economically, their domestic conditions would be less conducive to non-capitalist economic alternatives at home and anything other than alliance with the United States abroad. Moreover, national economic successes by these countries would provide positive alternative development models to those put forward by the communist camp.

Foreign aid was an early part of US economic assistance to all three countries. Thus, South Korea received some US$13 billion in American assistance; Taiwan received about US$5.6 billion (US$600 per capita in the Republic of Korea, US$425 per capita in Taiwan) (Cumings 1984). More than two-thirds of Japan's imports in 1947 were covered by US aid. Subsequently Japan's corporations benefited tremendously from military procurements during the Korean and Vietnam Wars; indeed, both were undeniable catalysts to Japan's subsequent and uninterrupted growth (e.g., Nakamura 1981; Kosai and Ogino 1984). In addition, US troops were used in the early post-war years in both Japan and South Korea to suppress anti-government protests and to provide armed support for pro-United

States governments. Secret payments from the Central Intelligence Agency (CIA) and other US agencies were also liberally spread among US supporters and pro-United States institutions in all three countries.

The strategic sustenance given to all three regimes by the US military was of great importance to their continuation and economic well-being. Military objectives insured that America would be the external patron for regime success in Northeast Asia; America's strategic policies opened up space for these three countries to pursue their own economic policies. Japan's overall international muscle allowed it substantial measures of independence from the United States from early on but, as late as the early 1980s, South Korea and Taiwan could probably not have remained in existence without the international support provided by both the markets and the military of the United States.

Equally important, and of greater weight as the immediate threats of foreign invasion or domestic subversion waned, for the bulk of the post-war period, the United States opened its domestic markets to exports from Japan, as well as from South Korea and Taiwan, on terms that were exceedingly generous and devoid of demands for reciprocal access. All three countries exported heavily to the United States while maintaining largely closed markets at home. This ability to export goods to the United States and the other advanced industrialized countries combined with the ability to nurture protected manufacturing and capital markets at home was vital to their economic successes. Domestic transformations in all three countries rested heavily on this imbalanced approach to trade and investment. Yet, in most models of Japanese (and Northeast Asian) economic development, US strategic contributions to economic growth are accorded little, if any, attention.[5]

A second set of international conditions was also important: that is, the relatively complementary nature of national economies across Asia. In the first few decades following World War II, Japan benefited greatly from the import of relatively inexpensive raw materials from elsewhere in Asia. As South Korea and Taiwan accelerated their industrial projects, they could often rely on more sophisticated Japanese technologies and business models. All three economies subsequently benefited from the growing markets for their exported goods across the rest of Asia. The region's national economies demonstrated a complementary mixture of strengths and weaknesses that came to be mutually beneficial across Asia.

A third condition was also critical to early Japanese and Northeast Asian success, namely the conditions of international finance. For most of the post-war period state bureaucracies in all three countries buffered their domestic economies from international financial and capital markets. As a result, even as late as the mid-1980s all three countries were able to retain high degrees of domestic control over monetary policy and exchange rates. This left them relatively free of the threat of leveraged buyouts, hostile takeovers, and the loss of national control over key industrial sectors. Mercantilist policies in trade were augmented by domestic insulation from potentially threatening international capital flows. In effect, all three could function primarily as domestically driven economies, with domestic savers cut off from access to internationally competitive rates of return and with national savings recirculated back to domestic users of capital at below market rates. Profits generated by nationally owned companies remained largely within national markets.

In addition to the shift to an international context far more favorable to market-oriented economics, all three of these conditions changed substantially by the mid to late 1980s in ways that had profound affects on continued developmental possibilities in Northeast Asia. When the United States emerged from World War II, its domestic GNP was roughly six times larger than the world's second largest economy, Britain. Meanwhile, Japan, South Korea, and Taiwan were all very much weaker than they were by the 1980s. As a consequence, the United States could cheaply and easily afford to be economically generous to all three, at little cost to its own domestic well-being. Certain individual US firms or sectors did suffer as a consequence of the growth in export competitiveness among Asian firms. But US policy-makers were typically tolerant of such seemingly normal market shifts in the broader interest of keeping close security relations with Asia.

For roughly a hundred years until the early 1970s, the United States had enjoyed a favorable balance of trade with the rest of the world. This balance swung to unfavorable with increasing speed from the Nixon administration onward. Contributing most heavily to this shift was the increasing import penetration of domestic American markets by Japanese and, later, Korean and Taiwanese products. As a result, US policy-makers came under ever-intensifying pressure to "do something" to protect American industries and jobs and to rectify the growing trade gap. The result, particularly with Japan, was a variety of so-called "voluntary export agreements," sector-specific targets for market openings and efforts to remove structural impediments to investments. Subsequently, the United States shifted to monetary agreements, including the Plaza and Louvre Accords of 1985 and 1987 respectively. These currency realignments among the major powers, including Japan, were designed to reconfigure each country's incentives for exports and imports. More recently, the United States applied a host of pressures to open up the domestic markets of all three to US investment and exports.

Such changes in US behavior made it increasingly problematic for old patterns of East Asian insularity to continue, requiring states to adapt to new realities. Ever more holes were punched in Asia's hothouses, exposing domestic manufacturers in the cozily insulated home markets to the chilling winds of foreign competition. Of particular importance was the fact that the currency realignments of Plaza and Louvre affected not only the value of the Japanese yen but also, through ripple effects, the values of both the won and the new Taiwan dollar.

All three Asian currencies jumped vis-à-vis the US dollar, thus undercutting the price competitiveness of exports from these countries. Moreover, stronger currency values also led to waves of outgoing investment by companies headquartered in all three countries, as overseas prices of land, labor, and production became irresistibly cheaper (see, *inter alia*, Naughton 1997; Pempel 1999c). Companies that were once largely domestic producers subject to national monetary and capital allocation policies became far more regional or international in their production, and far less subject to national capital controls. As many of these companies set up operations abroad, sharp divisions between companies and sectors that were truly internationally competitive and those whose businesses survived largely as a result of a closed domestic economy and government assistance were exposed.

In this context, even as governments continued to mediate the processes of liberalization, Asian regional successes contained certain seeds of destruction. As industrialization spread across the Asian region, more and more companies began to adopt the export-led model of growth. The result, in sectors such as steel, textiles, electronics, personal computers, semiconductors and shipbuilding, was the proliferation of international competition and in many cases the glutting of world markets with an oversupply of goods. The development model successfully pioneered by Japan and adopted with variations by South Korea and Taiwan eventually had its adherents in Malaysia, Thailand, Singapore, and even the PRC. As the Asian region flourished, its very success created region-wide conditions that made it ever more difficult to sustain on a permanent basis. This became particularly clear in the 1997–98 currency crises, when many Asian economies found themselves in a competitive race with one another to expand their share of world markets through production based on cheap labor. Competition with each other was inherently problematic; once the PRC, with its virtually infinite supply of cheap labor and tight national controls over capital, began aggressively pursuing the same goals, what had once been a race between a few Asian countries and the rest of the world was transformed into an intra-Asian bloodletting that left many of the participants as devastated as the American rust belt had been decades earlier (Pempel 1999a).

The focus on national economic success, and particularly the extent to which that success was achieved with high levels of social equality, had long made it easy to conclude that all of Japan (or all of Taiwan) was moving along a common trajectory. There is an old adage about the man who had his head in the oven and his feet in ice, but *on average*, should have been quite comfortable. Similarly, the models of Japanese development too easily obscured the extent to which overall growth and success in that country was the product of highly disparate and uneven performances in different sectors of the economy. By the early 1990s in Japan (and the late 1990s in South Korea and Taiwan) it had become clear that national economic success had long masked relatively large swaths of unadaptive and sclerotic private sector firms. The cumulative drag of so many inward-looking sectors and firms became an increasingly important proportion of the total national economies, particularly in Japan but later in South Korea as well.

This leads us to the second major flaw in the Japanese development models, namely their inherently static quality, which became apparent as they confronted the forces of liberalization. Many facets to this could be explored at greater length. The broad point can be captured, however, with several clarifying examples. As one example, consider the structural changes that take place as economies become more sophisticated. The models do little to account for the fact that relatively small and underdeveloped economies face quite different choices and constraints than do larger and more sophisticated ones. Countries (and private sector companies) anxious to "catch up" face many difficulties, but they do have the advantage of earlier examples of development that leave them with clear signposts as to

the technologies and industries they should be targeting. Once they have caught up, however, the path ahead becomes much murkier. During catch-up, industrial development can effectively proceed by relying on techniques such as copying, reverse engineering, and product refinement. Continued success after achieving greater sophistication in the economy, however, typically requires much heavier investments in research and development, more original design, attention to creating, rather than invading, markets, and the like. This is not to suggest that Japan, Korea, and Taiwan are inherently lacking such abilities, but national leaders and many individual companies within all three have had to confront such adjustments through rapid shock under present conditions in the world economy, and many found the transition less than simple.

Consider also the demographic changes that accompany rapid economic development. At base, the national population profiles of all three countries in 1990–2000 were substantially different than those in the early post-war years. Improved health care and birth control led to smaller families and longer lives. All three countries had benefited from expanding, young, and low-cost labor forces during the early years of their development. As industrialization moved forward, farms closed down and younger workers moved into cities to provide a large, reliable and low-cost workforce. Similarly, state expenditures for social welfare, public health, and retirement could be kept relatively low with a young population. By the 1990s, however, all three countries had aged considerably, creating corresponding increases in the costs of labor along with rising demands for welfare, health care, leisure, and retirement allowances. This was most especially true in Japan. Government on the cheap was less easy to sustain, as were ever-ready and cheap sources of private sector labor.

Finally, it is worthwhile examining the ways in which power, once institutionalized to provide a strong engine for growth, can become ossified and focused on self-perpetuation rather than its original mission of economic development. Long-term rule by the Liberal Democratic Party (LDP) in Japan, the Kuomintang (KMT) in Taiwan, and a succession of generals in South Korea, combined with well-entrenched national bureaucracies in all three, fostered political structures with explicitly privileged constituencies and guaranteed compensations. The result was that these constituencies became ever more focused on self-preservation and less on adjustment to changing domestic and international conditions that could undermine their holds on power – a factor that was and is critical to debates over liberalization. This problem became particularly acute in Japan, with the LDP increasingly concentrating its policy efforts on its least internationally competitive long-standing constituents, notably construction, agriculture, distribution, and, subsequently, banking and financial services. The results were devastating to the national economy.

Ironically, political democratization and changes in the rulers in both Taiwan and South Korea broke some long-existing hammerlocks on power in the late 1980s in ways that the Japanese system avoided. Still, failure to reform Korea's *chaebol* structures contributed greatly to the liquidity problems of 1997–98. KMT ownership of many of Taiwan's largest oligopolies created similar rigidities there.

In addition, the long-standing commitments to anti-communism in both countries have made it politically difficult for them to work toward more normalized, and presumably potentially highly profitable, economic relations with North Korea and the PRC.

The examples could be multiplied but the major point should be clear. Most models of Japanese development failed to account adequately for the inherent ways in which instruments and characteristics critical to success at one point in time might themselves become impediments to continued growth once initial developmental goals had been achieved. It is this difficulty of adaptation that continues to hamper the political and economic reorientation of Japan to a world in which economic liberalization has become the predominant paradigm. Japan has made certain moves to deregulate various sectors of its economy and to open up more of its state structures to popular input and electoral competition (see, for example, S. Vogel 1996; Gibney 1998; and the other Japan chapters in this volume). Individual corporations have also engaged in restructurings designed to adjust to more liberal market conditions in the domestic market. In many instances, however, these have resulted in more rules to ensure continued compensation for potentially injured constituents. To date, the country and its companies have been slow to break with the developmentalist past and to embrace a future based on liberalization.

Conclusion

The above analysis has made clear that, in light of recent downturns across Asia, there is far more merit to re-examining the Japanese developmental model than in discarding it as a simple byproduct of an earlier and more optimistic era. Such a re-examination, with an eye to both successes and stumbles, allows a better appreciation of both the contributions and the flaws in the model itself, as well as making us aware of how and in what ways it may adapt to the ongoing forces of liberalization.

For many, current economic problems provide proof that the alleged Asian miracle had been no more than a mirage. However, as was noted above, two major blind spots within the model contributed to the relentlessly optimistic views taken by both academics and policy-makers toward Japanese economic success for most of the last two decades. Most models took too little account of changing international conditions and of the ways in which domestic political, economic, and social conditions once conducive to growth could inhibit its continuation. Appreciation of these two blind spots allows one to return with some appreciation to the positive contributions that can still be applauded in the (admittedly now more limited) East Asian development model that, contrary to the new wisdom, is still of great relevance in understanding the moves toward and against liberalization taken by Japan and other countries in the region.

At least four of these remain worthy of underscoring, regardless of whether the models retain their full credibility. Most notably, models of Japanese (and Northeast Asian) development drew attention to the ways in which economic

growth could be successfully pursued as a catch-up strategy. Even after the economic crisis of 1997–98, the comparative economic infrastructures of Japan, South Korea, and Taiwan (as well as of Malaysia, Singapore, Thailand, Hong Kong, and even Indonesia) were vastly superior to those of countries counted as their equals only a decade or two earlier. Second, the development models demonstrated with unmistakable clarity that economic growth could advance along more than one path – indeed, more specifically, they reinforced the more general argument that there was more than one way to organize a capitalist economy.[6] This serves as a reminder that there is also more than one path to liberalization. Third, the models drew new attention to the importance of public policy choice and the design and potency of political institutions, even when these were accorded less overt endorsements of causal primacy, as was the case in most economic models. The models advanced to explain the experiences of success were all compelled to recognize the inherent economic power of political choice. Fourth, virtually all of the models stressed to a greater or lesser extent the importance in any national economy of mutually reinforcing linkages between the state apparatus and private market actors, which also continues its relevance in debates over liberalization. If "state" and "market"' were in competition elsewhere in the world, in Japan, and much of Northeast Asia, they were far more frequently in collaboration.

All of these features deserve recognition. The Japanese development model did a great deal to bring them front and center in comparative analysis as well as in the thinking of policy-makers charged with advancing national economic development. At the same time, the current economic problems in Japan, traced as they have been to shifts in international political power balances and particularly to a reconfiguration of international finance, make it clear that economic development strategies can no longer be nurtured in nationally insulated vacuums. The prevailing orthodoxy of economics has become liberalization, and national leaders anxious to achieve success today must be wary of assuming that they can emulate the experiences of Asia's success stories too directly. The United States is surely far less likely to tolerate, let alone embrace, mercantilist approaches today than it was during the heights of the Cold War. Success may well depend too on compatible and supportive economic conditions throughout its regional neighborhood. And new conditions of global capital will make purely domestic control of capital investments highly problematic.

In addition, developmentalists should learn from Japan and Northeast Asia the value of flexibility and the dangers of entrenched power, twin elements of added importance in the contemporary pro-liberalization context. Unshakable commitments and compensations to constituents unable to contribute to economic growth, while perhaps socially stabilizing, can become impediments to rapid adjustment to changing economic needs. Development, as Joseph Schumpeter (1970) made clear decades ago, involves not only the ability to generate the new, but also the ability to destroy the old. "Creative destruction" is as critical an ingredient of growth in the current century favoring liberalization as it was in the last favoring development.

Notes

1 Classic examples of such an approach are Pye (1985) and Tai (1989).
2 This point is explored at length in Pempel (1989). See also Sawyer (1976) and Verba *et al.* (1987).
3 A useful comparative table summarizing finding on Gini Indexes for several major NICs is presented in Haggard (1990: 226). See also Koo (1984) Evans (1987), and Schwartz (1989: 266).
4 Among the other relevant studies, see Pempel (1976, 1999b), Amsden (1989), Wade (1990), and Pekkanen (2003).
5 A particularly important exception in the case of South Korea is Woo (1991).
6 Among the more prominent works in this field see Albert (1993), Hollingsworth *et al.* (1994), Pempel (1998), and P. A. Hall and Soskice (2001).

Developmental dilemmas in China

Socialist transition and late liberalization

Kellee S. Tsai and Sarah Cook

China's stunning economic growth since the late 1970s has led some scholars to propose that the post-Mao regime has evolved into a "developmental state," mirroring the post-war path of its East Asian neighbors. On the surface, the party-state has indeed demonstrated key developmental state qualities; these include the articulation of national economic priorities, the establishment of specialized bureaucracies, the targeted creation of industrial sectors and export-processing zones, and the ability to thwart popular political resistance. This chapter contends, however, that China's developmental process has deviated from core components of the developmental state model in four important respects.

First, unlike the East Asian newly industrialized countries (NICs), China is a transitional economy that faces the dual task of dismantling socialist institutions while constructing ones that promote a market-oriented approach to growth. Second, and relatedly, China may also be considered a late liberalizer. As pointed out in the first chapter of this volume and in T. J. Pempel's chapter, developing countries like China now face different global economic conditions from preceding generations of late industrializers; today's developing countries are advised to pursue more liberal rather than statist development strategies. Third, China's reform-era policies differ in substance from those deemed to be core policies of the developmental state. Fourth, subnational governments have played a key role in defining the terms for local development. In political reality, the PRC state does not operate as coherently or effectively as would be expected in a typical developmental state. While a major task of post-Mao reformers has been to strengthen the state's institutional capacity for the implementation of economic policies, in the interim, China's reform-era growth has given rise to a host of serious political and social challenges, which require ongoing compromises in policy direction rather than linear progression toward greater liberalization. Analytically, this points to the need for a broader notion of development than the conventional economic-centric one that characterizes much of the developmental state literature.

There is significant variation within the literature on the developmental state (DS). Whether or not China is considered as representing a similar model depends in part on the core elements attributed to such states. For clarity, we distinguish between the "ideological" and "institutional" branches of developmental state theories. The earliest literature on China as a DS focused more on the broader