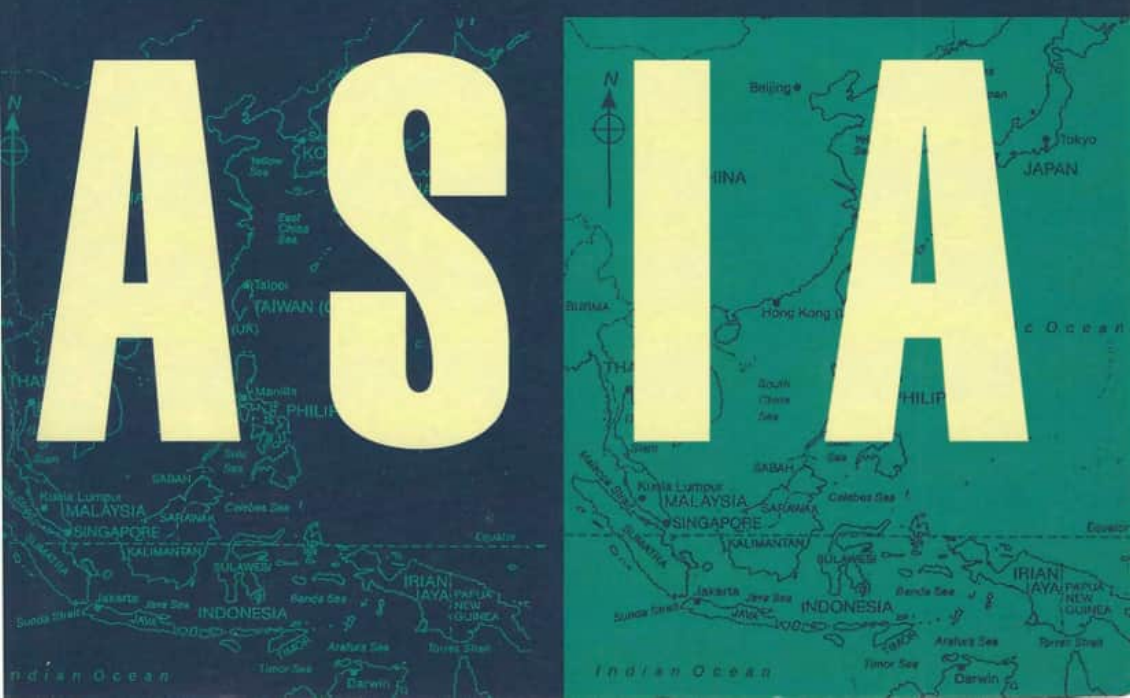
EDITED BY ANDREW MACINTYRE

BUSINESS AND GOVERNMENT IN INDUSTRIALISING ASIA



Business and Government
in Industrialising Asia

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Edited by Andrew MacIntyre

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Abbreviations

AWSJ	*Asian Wall Street Journal*
AWSJW	*Asian Wall Street Journal Weekly*
AY	*Asia Yearbook*
CFC	Central Finance Committee (Taiwan)
DFI	Direct foreign investment
FEER	*Far Eastern Economic Review*
FKI	Federation of Korean Industries
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GNP	Gross National Product
HCI	Heavy and chemical industries
HICOM	Heavy Industries Corporation of Malaysia
ICA	Industrial Co-ordination Act (Malaysia)
IMF	International Monetary Fund
JDB	Japan Development Bank
JECC	Japan Electronic Computer Company
JPPCC	Joint Public and Private Sector Consultative Committee (Thailand)
KADIN	Chamber of Commerce and Industry (Indonesia)
KMT	Kuomintang (Taiwan)
MCA	Malaysian Chinese Association
MEA	Ministry of Economic Affairs (Taiwan)
MIC	Malaysian Indian Congress
MIDA	Malaysian Industrial Development Authority
MITI	Ministry of International Trade and Industry (Japan)
MNC	Multinational corporation
NBFI	Non-bank financial institution
NEP	New Economic Policy (Malaysia)

NIC	Newly industrialising country
NTT	Nippon Telegraph and Telephone
OECD	Organization for Economic Cooperation and Development
OMA	Orderly Marketing Agreement
QIO	Quasi-internal organisation
SOE	State-owned enterprise
UMNO	United Malays National Organisation
WSJ	*Wall Street Journal*

Preface

There has been much lively discussion about the causes of industrialisation in recent years. Some things have become clear from the various debates. We know that policy has an important bearing upon economic performance. And we know that politics critically constrains policy. However, specifying the ways in which political arrangements or, more broadly, institutions constrain policy and thus performance has proved much less tractable. This volume seeks to contribute to that task by focusing on the interaction between business and government in a range of industrialising countries in Northeast and Southeast Asia. As anyone familiar with the political economy literature on this part of the world will be aware, there has been surprisingly little effort devoted to such a comparison. In spite of this, it is potentially rich with theoretical implications, for we have strong economic performances arising from quite diverse national political settings.

This book comprises ten original essays by specialists with theoretical and country-specific expertise from around Asia, Australia and the United States. In constructing a cross-national research project, selectivity inevitably comes into play. For a number of reasons, but principally enhanced comparability, we have focused primarily on six countries with established market-based economic systems: two well-recognised Northeast Asian success stories—South Korea and Taiwan—together with the four emerging Southeast Asian industrial economies—Thailand, Malaysia, Indonesia and the Philippines. A small but nagging difficulty associated with this range of countries concerns geographical nomenclature. The term 'East Asia' is widely used in two quite distinct ways: some commentators use it to refer to the area north of and including Hong Kong, while others use it to embrace all of Southeast Asia as well. There is no simple solution to this problem. In an effort to minimise confusion we have opted to avoid the term where possible, and instead to use 'Northeast Asia' and 'Southeast Asia' in referring to these two sub-regions.

Many debts are incurred in a study of this sort. In developing the project, my task as editor has been greatly assisted by thoughts and suggestions from a range of people, including: Bob Elson, Hal Hill, Yan Islam, Chalmers Johnson, Anek Laothamatas, Jamie Mackie, Chung-in Moon, Dick Robison, Hadi Soesastro, Randal Stewart and Nancy Viviani. Particularly heavy debts are owing to Rick Doner, Stephan Haggard, Paul Hutchcroft and John Ravenhill. Grateful thanks are also due to Mark Tredinnick and Margaret Jones of Allen & Unwin, and Roger Haydon of Cornell University Press. Finally, special thanks go to Robyn White and Jennilyn Mann for wordprocessing and production assistance.

Andrew MacIntyre
Brisbane
January 1994

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1 Business, Government and Development: Northeast and Southeast Asian Comparisons

Andrew MacIntyre[1]

Interest in the interaction of government and business in differing national settings has surged among political scientists over the last ten to twenty years, generating a sizeable literature loosely covered by the label comparative political economy. Japan was the first Asian country to attract extensive attention in this vein, as scholars sought explanations for its strong economic performance relative to a number of other major advanced industrial economies (Katzenstein 1978; Zysman 1983; Wilks & Wright 1987). Subsequently, interest in Asia began to grow as recognition spread that several so-called newly industrialising countries (NICs) were following in Japan's high growth footsteps. Miraculously, these NICs were shaking off their Third World status and successfully exporting manufactured goods to the advanced industrial countries. Recently, the locus of interest has widened further to include a number of Southeast Asian countries making very impressive economic progress. This book seeks to examine in a comparative way the nature of government–business interaction in a number of the industrialising countries of Northeast and Southeast Asia: South Korea, Taiwan, Thailand, Malaysia, Indonesia and the Philippines.

There is a widely held notion that the nature of relations between business and government is a crucial variable bearing upon national economic performance. As one scholar put it: 'Their interaction with each other and with foreign interlocutors is seen as the source of dynamism and coherence, or defeat' (McVey 1992: 14). In spite of the burgeoning interest in this field, the study of relations between government and business is still in a developmental stage and lacks well recognised parameters. In simple terms, however, it can perhaps be agreed that there are two basic dimensions to the subject: the nature of the involvement of government in markets; and, conversely, the nature of the involvement of business in political life. This introductory essay and the volume as a whole explore both of these dimensions in seeking to analyse the nature of relations between business and government in Northeast and Southeast Asia, and the significance of these relationships for economic development.

A comparison between the Northeast Asian NICs and the newly emerging economies of Southeast Asia is attractive for a number of reasons. The most basic reason is that this is largely uncharted intellectual terrain. To be sure, there are comparative studies of the first generation NICs (Deyo 1987; White 1988; Haggard 1990) and now there are also comparative studies of the emerging Southeast Asian countries (Robison et al. 1987; Yoshihara 1988; Doner 1991; MacIntyre & Jayasuriya 1992a; McVey 1992; Hawes & Liu 1993). However, scholarly work on the two sub-regions has developed in isolation, so much so that there are very few studies indeed which attempt to bring the two together.[2] It is surprising that the 'area studies' bias in much of the scholarship on Asia should still obstruct comparative research in view of the reality of rapidly intensifying economic and political linkages between Northeast and Southeast Asia. Moreover, the absence of careful cross-regional comparisons has contributed to the emergence of popular—but untested—perceptions that the impressive economic transformations under way in Southeast Asia are largely replicating what might be thought of as a Northeast Asian model.

As is well known, in the early 1960s South Korea and Taiwan moved away from a dependence upon import substitution and adopted developmental strategies featuring the promotion of labour-intensive manufactured exports. Roughly two decades later, in the mid-1980s, Thailand, Malaysia, Indonesia and to a much lesser extent the

TABLE 1.1 Selected Economic Indicators

	GNP per capita US$		*Average annual GDP growth (%)*		*Manufacturing as a share of GDP (%)*		*Manufactured exports as a share of GDP (%)*	
	1965	1990	1965–80	1980–90	1965	1990	1965	1990
Korea	106	5662	9.9	9.7	18	31	3	25
Taiwan	222	7,905	9.9	8.3	18	34	6	40
Thailand	143	1,444	7.3	7.6	14	26	1	18
Malaysia	321	2,270	7.3	5.3	9	27	2	30
Philippines	187	720	5.8	1.0	20	25	1	12
Indonesia	37	572	7.0	5.4	8	20	1	8

Source: International Economic Database (Australian National University) and World Tables (World Bank).

Philippines, have also adopted more outward-looking economic policies and implemented a variety of adjustment measures which have yielded a boom in manufactured exports and very strong economic growth rates. However, as this study will show, while the successful Southeast Asian states do indeed seem to be moving rapidly up the export-led, high growth development trajectory of the Northeast Asian NICs, they are doing so on the basis of formulae which feature some fundamental differences in the nature of relations between government and industry.

This introductory essay presents an overview of the themes examined in the rest of the volume. It is organised into four parts. The first discusses business–government interaction in the successful Northeast Asian economies, focusing on two key variables which feature prominently in the literature: state strength and strategic intervention in markets. The next section highlights the contrasts between the experiences of Taiwan and South Korea on the one hand, and those of Malaysia, Indonesia, the Philippines and Thailand on the other; emphasising the fact that these Southeast Asian states have all been markedly less insulated from business interests, and have had relatively little success with interventionist industrial policies. This is followed by a discussion of problems in interpreting these comparisons and their implications for theoretical debate about development. The final section of the essay provides an overview of the structure of the volume as a whole, and introduces the major themes of the various chapters which follow. Before we proceed to explore these various issues, however, we need to consider the scope of the terms 'government' and 'business' as used in this book. Regarding the former, the emphasis of this study is on the national level of government rather than regional or local political institutions. In our use of the term business, the focus is on medium and large scale enterprises, most of which are located within the rapidly growing manufacturing and services sectors; although some modern agro-businesses and resource extraction industries also feature prominently in the Southeast Asian economies.

BUSINESS AND GOVERNMENT IN NORTHEAST ASIA

By comparison with the body of academic writings on the business–government nexus in Southeast Asia, the literature on Northeast Asia is large and diverse. Notwithstanding differences of emphasis and orientation, an outstanding theme in the literature on Taiwan and South Korea—or developmental states, as Chalmers Johnson (1987) has called them—is the importance of the nature of relations between government and business as a variable underpinning their spectacular economic performance. There are two broad clusters of ideas here, which for convenience may be organised under the headings of state strength, and strategic intervention in markets.

The first of these is both the most general and fundamental. The concept of state strength is notoriously slippery, and partly because of this has become less fashionable. Doner's (1992: 399) formulation is useful: states are regarded as strong to the extent (a) that they are insulated or shielded from distributional societal pressures, and (b) that they are sufficiently coherent and coordinated in organisational terms to allow effective implementation of policies. Both of these factors receive heavy emphasis in the political economy literature on South Korea and Taiwan (Chu 1989; Deyo 1987; Haggard 1990; Jones & Sakong 1980; Onis 1991). The ability of the state elite to formulate economic policy without becoming captive to rent-seeking societal groups is widely regarded as having been crucial in the shift away from import substitution towards a more outward-looking stance. Specifically, the state is seen as having been relatively independent of distributional pressures from business. While the corporate sector certainly prospered in South Korea and Taiwan and was in a de facto alliance with government, during the crucial period of the 1960s and 1970s this alliance seems to have been an unequal one. Collective action by business groups was curtailed by an authoritarian corporatist framework for interest representation. Institutional arrangements of this sort, and a willingness to resort to coercion, ensured that the 'state elites have unambiguously been the senior partner in their relations with business groups'. (Onis 1991: 119).

In addition to government leaders managing to hold distributional coalitions at arm's distance, the internal characteristics of the economic bureaucracies in the Northeast Asian NICs—the second dimension to the concept of state strength—are also significant. South Korea and Taiwan appear to have had centrally coordinated and disciplined elite bureaucracies which (at least in the case of the key economic agencies) have been less prone to the problems of inefficiency, incompetence and official corruption. Although not absent, self-enriching or predatory behaviour among officials is thought to have been less common than in most other developing countries (Johnson 1987; Onis 1991). In their chapters in this volume Trevor Matthews, John Ravenhill, and Stephan Haggard wrestle with the task of satisfactorily explaining this phenomenon.

Apart from creating sufficient 'political space' for officials to focus on policy development free from the diversionary pressures of sundry rent-seekers, the existence of strong states in the Northeast Asian

NICs significantly increased the scope for intervention in the market place (Biggs and Levy 1991). There is, of course, intense debate over the extent to which government policy 'followed' or 'led' the market, and the efficacy of interventionist-style industry policies (compare, on one hand, World Bank 1992a; Wade 1990; Alam 1989; Amsden 1990; White 1988; with, on the other, Islam 1992; Hughes 1988; World Bank 1987; Balassa 1981; Little 1981). Setting aside for the moment the question of the *causal* significance that should be attributed to state interventionism, there seems little doubt that in a number of important respects policy makers in South Korea and Taiwan were not willing to sit back and allow industrial development to be shaped only by market preferences. Instead—to whatever effect—governments intervened extensively in an attempt to guide corporate behaviour and ultimately the pattern of industrial development.

The strategies adopted by Taiwan and South Korea for promoting key industries varied considerably (Haggard 1990). In Taiwan, the state typically intervened through direct investment and the establishment of a network of state-owned enterprises. By contrast, South Korea's approach was more akin to the Japanese model from the 1950s and 1960s: planning officials sought to harness the energies of private corporations by assisting them and inducing them to invest in prioritised industries. Among the incentives used to encourage corporate cooperation were the granting of credit on very favourable terms, the reduction or elimination of the pressures of local and international competition (at least during the infant industry stage), and the provision of various forms of infrastructural support. Amsden (1990) and others argue that industrial targeting initiatives in South Korea did not fall prey to rent-hungry corporate groups because the state was able to 'discipline' firms by pressuring them to make productive use of the various subsidies they received and, typically, to lift export performance (Biggs & Levy 1991; Rhee 1984, Hong 1979). Such pressures were frequently anything but subtle, as suggested by the often-heard anecdote about Korean manufacturers being told by stony-faced government officials that, unless they lifted their export levels, their electricity supply would be cut off. More broadly, in both Korea and Taiwan there were moves to limit direct foreign investment (DFI). By comparison with some Latin American countries, the aggregate level of DFI in Taiwan and particularly South Korea has been low (Haggard & Cheng 1987; Hill 1990; Stallings 1990). Although foreign capital was important in funding rapid industrialisation in Northeast Asia, it primarily took the form of debt rather than equity. Foreign finance and technology were purchased, but multinational corporations (MNCs) were not admitted in large numbers to set up direct operations. In South Korea, those MNCs which were granted entry were obliged to adapt themselves to national priorities (Mardon 1990). More broadly, it is thought that the relatively modest level of DFI admitted by Taiwan and South Korea enabled them to avoid the problems often associated with a large scale MNC presence. The corporate sector was dominated by national firms rather than MNCs (Gereffi 1990: 93–4), and accordingly most distributional coalitions and corporate rent-seekers were local rather than foreign.

To summarise, allowing for important nuances such as variation across time and industrial sector,[3] the general picture which emerges from most accounts of business–state interactions in the Northeast Asian NICs is one in which the formulation and implementation of economic policy has not been greatly constrained in a direct (or instrumental) way by the preferences of business.[4] Moreover, the state itself has been sufficiently competent, coordinated and disciplined to intervene in markets and guide company behaviour without apparently falling victim to chronic government failure. The ability of these strong states to both operate in a coherent fashion and avoid diversion by rent-seeking business interests, underpinned the reorientation of economic policy and push for internationally competitive export industries in the 1960s.

SOUTHEAST ASIAN COMPARISONS

How does this picture compare with the experiences of the recently emerging Southeast Asian countries? For roughly two decades prior to the mid-1980s, Malaysia, Thailand, Indonesia and the Philippines achieved rates of economic growth which, though not equalling the spectacular achievements of South Korea and Taiwan at that time, nonetheless exceeded the performance of most other developing countries (James et al. 1989; World Bank 1993). Unlike the Northeast Asian experience, the strong growth rates of these Southeast Asian countries were largely based upon primary resource exports and import-substituting industrialisation. As Doner and Hawes (forthcoming: 15–16) argue, rich natural resource endowments (or more specifically, the foreign exchange earnings arising from their export) enabled Southeast Asian governments to maintain import-substitution arrangements for much longer than was the case in resource-poor Taiwan or South Korea. Beginning in the early- to mid-1980s all four of these countries have been forced by various exogenous economic developments to initiate major structural adjustment programs, under which they have moved to open up their economies and develop internationally competitive manufacturing industries (MacIntyre &

Jayasuriya 1992a). After several difficult years, they (with the exception of the Philippines) experienced major change, with growth rates again rising and, importantly, exports of labour-intensive manufactures (such as textiles, footwear and electronic consumer goods) expanding very rapidly. In short, since the mid-1980s these economies have appeared to be following in the footsteps of the Northeast Asian NICs.

No neat summary of the dynamics of the business–government interactions in the four Southeast Asian countries is possible, for the diversity among them is considerable. Nonetheless, it is apparent that while they may be moving (at quite different speeds) along an export-led path to industrial development, they are doing so on the basis of frameworks for government–business interaction which differ significantly from those of the Northeast Asian NICs. This can be illustrated by focusing on the two variables emphasised in the earlier discussion of South Korea and Taiwan: state strength, and the nature of state involvement in the economy.

Taking the first of these variables, all of the Southeast Asian states appear markedly less 'strong' than their counterparts in Taiwan or South Korea—particularly during the latters' economically transformative years of the 1960s and 1970s. Southeast Asian bureaucracies have not been as insulated from distributional pressures or, apparently, as coherent or high calibre. In terms of the degree to which economic policy makers are insulated from contending societal pressures, Indonesia is the country which appears to come nearest to South Korean or Taiwanese experience. Indonesia has had a stable form of authoritarian government for over twenty-five years. The military-based regime of former-General Suharto has been remarkably successfully in limiting popular participation in politics and reducing the scope for collective action through an effective authoritarian corporatist framework. Political parties are managed, the labour movement is tightly controlled and peak business associations are contained and co-opted. However, even though the scope for mass political participation has been severely limited, economic policy-making processes in Indonesia could scarcely be described as being insulated in the fashion of Taiwan or South Korea. The most obvious difference is the pervasive importance of patrimonial or clientelistic links between government figures and business people. A distinctive feature of clientelistic links between business and government in Indonesia—along with Malaysia and Thailand—relates to the fact that the business community is overwhelmingly made up of people of Chinese descent. Over the course of the last century immigrant Chinese came to dominate local commercial activity, but as small and wealthy ethnic enclaves they became the subject of intense resentment among the indigenous population.

In the period since the Second World War there have been many instances of popular and official harassment of Chinese minorities in these countries (McVey 1992; Mackie 1991; Golay 1969; Skinner 1957a). Vulnerability to periodically violent and destructive outbursts of indigenous resentment has traditionally led Chinese business people to avoid high profile collective political action and to rely instead upon a more covert form of political representation—clientelism.[5] In return for protection and policy favours, Chinese business people would provide cash, stocks and company directorships to powerful members of the indigenous political elite. The contrast with Taiwan here is intriguing; as Yun-han Chu's chapter in this volume makes clear there has been a marked ethnic division between the native Taiwanese-dominated business community and the mainlander-dominated state and party elite. In spite of this clientelism appears to have been much less prominent.

In Indonesia, this pattern of personalised and dyadic linkages between officials and entrepreneurs applies from the base to the apex of the political and commercial hierarchies. Business associates of the President, ministers and other senior officials have been able to secure extraordinary favours and preferential treatment in the application of government regulation. As anywhere, those elements of economic policy which have public good characteristics are less prone to distributional pressures (Olson 1982). In Indonesia, however, outside crucial elements of macroeconomic policy the list of policy areas which are not susceptible to crony manipulation is not a long one. The selective application of government policy and the granting of sundry rents on the basis of personal connections is, of course, the bane of technocratic officials in the key economic ministries seeking to promote efficiency and national competitiveness. A crude indication of the importance of clientelistic connections is the fact that business success seems to be roughly proportional to the political standing of a business person's patrons in government; not surprisingly, then, the most successful firms in Indonesia are almost all linked to the President.

In addition to individualistic efforts by business people to influence the policy process—even in Indonesia, the Southeast Asian country in which collective action is probably least developed—there are growing signs of organised group action among business people seeking a voice in the determination of policy. Although only a nascent trend, it is noteworthy that it has emerged at the same time as national economic policy is shifting away from an emphasis on import substitution and moving towards greater emphasis on promoting international competitiveness, particularly in manufactures.

The extent to which economic policy making in Indonesia is subject to societal pressures should not, however, be overdrawn, since it appears to be even more the case in the other Southeast Asian countries under consideration here. As Paul Hutchcroft's chapter makes clear, of the four, the Philippines undoubtedly has the most decentralised political system, with the economic policy machinery routinely hijacked by powerful business interests. In this respect the Aquino administration proved a disappointment to those hoping for a break from the long history of crony business figures being allocated fabulous rent-taking opportunities by patrons in government (Hutchcroft 1991). The chapters by Alasdair Bowie and Anek Laothamatas demonstrate that Malaysia and Thailand lie somewhere between Indonesia and the Philippines in this regard: economic policy-making processes are not highly insulated, but nor is the problem of bureaucratic capture endemic. Clientelism is commonplace in both, and both have relatively open political systems, with political parties and business organisations providing more meaningful channels for political action by business groups than in Indonesia. In Thailand, for example, recent studies have pointed to the development of liberal corporatist structures for peak level business representation and highlighted the impact of collective business action in pushing for economic reform (Anek 1992; Pasuk 1992; Doner 1991; Ramsay 1987). Again, it is noteworthy that these developments have coincided with the reorientation of economic policy away from an emphasis on import substitution.

Considerable emphasis has been given to the more open and permeable nature of the political systems in Southeast Asia when contrasted with the strong states of the Northeast Asian NICs. Also revealing are the comparisons between Southeast Asian experiences and those of South Korea and Taiwan in terms of the second element of the notion of state strength: an organisationally centralised and high calibre bureaucracy capable of effectively implementing policy.

Generating comparative statements in this area is extremely difficult, for there has been very little research into the organisational dynamics of bureaucratic agencies in Southeast Asia. Students of South Korea and Taiwan are better served in this regard (Evans 1992; Choi 1991; Haggard et al. 1991; Kim et al. 1985; Lee 1968). Nonetheless, the proposition that the calibre and effectiveness of bureaucratic agencies in the four Southeast Asian countries under consideration here falls well short of most accounts of their Korean and Taiwanese counterparts is most unlikely to be challenged by students of Southeast Asian politics (Hawes & Liu 1993: 650; Doner 1992: 405; McVey 1992; Crone 1988; Crouch 1984). While it is not possible to provide a carefully calibrated comparison of the 'softness' (Myrdal 1968) of these states, a rough ranking is feasible. Peter Evans (1989) has proposed a continuum of state structures ranging at one end from the developmental states of Northeast Asia, through to predatory and 'klepto-patrimonial' states such as that of Mobutu's Zaire. The four Southeast Asian states can be considered intermediate cases, lacking the strength of the Northeast Asian NICs, but equally not being hopelessly corrupt or captured. In the absence of reliable comparative studies, probably the most that can be done to distinguish among the Southeast Asian states is to suggest that the Malaysian state is perhaps a little stronger than the others and the Philippines state something of an outlier, being considerably weaker than the rest. The point to be emphasised, however, is that although the state structures in Malaysia, Thailand and Indonesia appear to be less coherent and disciplined than in South Korea or Taiwan, they are nonetheless presiding over impressive economic transformations.

The contrast between Northeast and Southeast Asian experiences is not confined only to state strength, there are also marked differences in terms of our second variable—the nature of state involvement in the economy. We have already mentioned that there are some important similarities between (a) the moves of the four Southeast Asian countries in the 1980s to shift away from reliance upon import substitution towards a more export-oriented approach to industrial development and (b) the adoption of more outward-looking economic policies by Taiwan and South Korea in the early 1960s. Although there is significant variation among the Southeast Asian countries (with the Philippines again being the outlier), it is generally the case that since the mid-1980s (when labour-intensive exports began to boom) foreign investment regimes and trade and industry policies have been less interventionist than was the case in the Northeast Asian NICs during the 1960s and 1970s. While its causal significance is the subject of debate (and is pursued vigorously in the chapters by Islam, Matthews and Ravenhill), few would deny that relatively sophisticated and coordinated forms of market intervention did in fact take place in Taiwan and South Korea after the shift to export-led growth. By contrast, in most of the Southeast Asian countries, the swing towards labour-intensive, export-led industrialisation has been accompanied by a reduction in state intervention. In those countries where state intervention continues to be extensive (though lessened) it is of a decidedly different nature from the patterns exhibited in the Northeast Asian NICs.

By comparison with the other Southeast Asian countries (and even more so Taiwan and South Korea) the level of state involvement in the Thai economy has been modest, particularly after the reforms of the mid-1980s. State-owned enterprises (SOEs) in Thailand have been relatively few, tariff and non-tariff barriers have not been particularly high by developing country standards (with the exception of some particular industries such as automobiles), there has been relatively little state intervention in credit allocation for industrial policy purposes, and DFI has been generally welcomed (Warr 1993; Doner & Unger 1993; Pasuk 1992, 1980; James et al. 1989; Findlay & Garnaut 1986). In Malaysia too the role of the state in the marketplace, although significant, has been comparatively modest. During the 1970s and early 1980s Malaysia experimented with various import-substituting measures, launched a state-driven push for heavy industrialisation, and expanded its SOE sector. However, a marked shift in policy in the mid-1980s saw this nascent trend towards *dirigisme* reversed. Trade barriers were reduced, the heavy industry drive was downgraded, SOEs were privatised and DFI was allowed to flood in (Lim 1992; James et al. 1989; Hill 1993).

The Philippines lies somewhere between Thailand and Malaysia on the one hand and Indonesia on the other. It has had a long history of protectionist trade policies and in the 1970s the number and scope of SOEs expanded quite rapidly. As in Malaysia and Thailand, from around the mid-1980s there has been a push to open the economy and make it more internationally competitive. While there has been progress, the pace of change in this direction has been very much slower than in the other Southeast Asian countries (Jayasuriya 1992; Hill 1993)—largely because key sections of the state have been captured by powerful business interests.

Of the four Southeast Asian countries, Indonesia has the most extensive record of state interventionism. It has long had a large SOE sector and inward-looking trade and foreign investment regimes. During the 1970s, the boom in oil prices made possible a state-led push for heavy industrialisation. This generally *dirigiste* picture began to change in the mid-1980s with moves to deregulate the economy and facilitate the expansion of labour-intensive manufactured exports. Trade barriers affecting export industries were reduced and foreign investment was actively courted. Notwithstanding these and other moves to emphasise private sector initiative and expose firms to greater local and international competition, the state in Indonesia continues to play a generally more interventionist role than in other Southeast Asian countries. And yet, even in Indonesia, the parallels with Taiwan and South Korea in the 1960s and 1970s are limited. The state in Indonesia is neither sufficiently insulated from distributional pressures, nor adequately endowed with bureaucratic resources, to prevent its investments being dissipated through inefficiency and corruption. Government failure appears to be a more pervasive problem than in Taiwan or South Korea. A convenient illustration of the differences is provided by comparing state involvement in credit allocation in Indonesia and South Korea. While the state intervened extensively in both cases, there are fundamental differences. First, unlike South Korea, preferential lending in Indonesia has not been heavily biased towards the manufacturing sector. Secondly, and more importantly for present purposes, government lending priorities in Indonesia have been subject to extensive manipulation by bank officials and well-connected business people (MacIntyre 1993). In short, the image from Northeast Asia of a strong state competently intervening in markets without being captured on a routine basis by rent-seekers has little application in Indonesia.

To summarise, the patterns of state involvement in the economy in the industrialising Southeast Asian countries have generally been quite different from those of the Northeast Asian NICs. The Southeast Asian states have either not attempted to involve themselves in governing the behaviour of firms to a similar extent, or, if they have (as in Indonesia), intervention has generally been poorly coordinated and subject to extensive manipulation by business people with powerful patrons in government. More pointedly, in Thailand, Malaysia and Indonesia the swing towards an export-led high growth trajectory which began in the mid-1980s was accompanied, not by extensive state intervention, but by a marked reduction in the economic role of the state. Rather than disciplined intervention, the successful Southeast Asian states have tended to opt for what might be termed 'strategic retreat'. Government failure through inefficient or unproductive intervention in markets has been a significant problem in Southeast Asia, particularly in interventionist Indonesia. Bureaucratic agencies in these Southeast Asian countries generally appear to be less coherent, less competent and less disciplined than their Northeast Asian counterparts. Perhaps in conscious recognition of the limitation of their bureaucratic resources, the trend in these countries in the late 1980s and early 1990s has been to alleviate the risk of government failure by withdrawing—neo-liberal style—from the marketplace and allowing firms greater sovereignty over resource allocation decisions.[6] In short, during their respective periods of economic reorientation, the economic relationships between firms and states differed markedly between Northeast and Southeast Asia.

Meaningful quantification of these differences is, of course, extremely difficult. One indicator of the contrast can, however, be obtained from a comparison of the extent to which these countries opened their doors to DFI during their respective periods of economic transition. During the 1960s (and even today) DFI played only a modest role in South Korea and Taiwan. By contrast, in the latter 1980s all four of the Southeast Asian countries—even Indonesia with its strong tradition of economic nationalism—have flung open their doors to DFI (Hill 1990). Figures 1.1 and 1.2 chart net DFI as a percentage of total investment.

BUSINESS, GOVERNMENT AND DEVELOPMENT

The discussion thus far has highlighted important contrasts between the experiences of the Northeast Asian NICs which shifted to export-led industrialisation beginning in the early 1960s, and the Southeast Asian countries which began to do so during the 1980s. Two basic empirical claims arise from this comparison: first, the politics of economic restructuring in the strong states of Northeast Asia has differed significantly from the experiences of the weaker Southeast Asian states; and secondly, since their adoption of more outward-looking economic policies, Southeast Asian states have intervened in their economies less extensively and in a less disciplined fashion than their counterparts in Northeast Asia.

How should this apparent divergence be interpreted and what implications does it carry for theoretical debates about the nature of business–government interaction and economic development? Two quite different responses seem plausible. One is to view the experiences of the three most successful Southeast Asian economies—Malaysia, Thailand and Indonesia—as posing a challenge to the now well-established literature arising from Northeast Asia with its emphasis on the importance of relative state autonomy and state capacity. It is widely recognised that strong states (or, more crudely still, authoritarian states) are by no means a guarantee of good economic performance; much more problematic is the question of whether sustained rapid development can be achieved in the absence of a strong state. If, in simplified terms, a strong state was a key element in the success of South Korea and Taiwan in surmounting the problem of opposition to economic restructuring by rent-hungry distributional coalitions, how is it that countries such as Thailand, Malaysia and Indonesia, with states that appear markedly weaker, have also managed to achieve such impressive results? The evidence from these countries seems to suggest that a strong state capable of withstanding rent-seekers and governing the behaviour of firms through coordinated market intervention may not be a prerequisite for major economic adjustment after all. If a swing to rapid export-led industrialisation

Figure 1.1 Direct foreign investment as a percentage of total investment, the Philippines, Thailand and Malaysia 1965–1991.

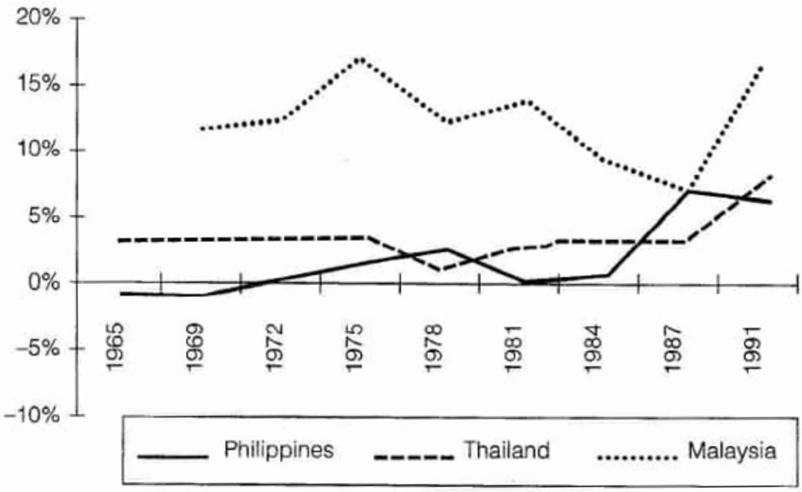
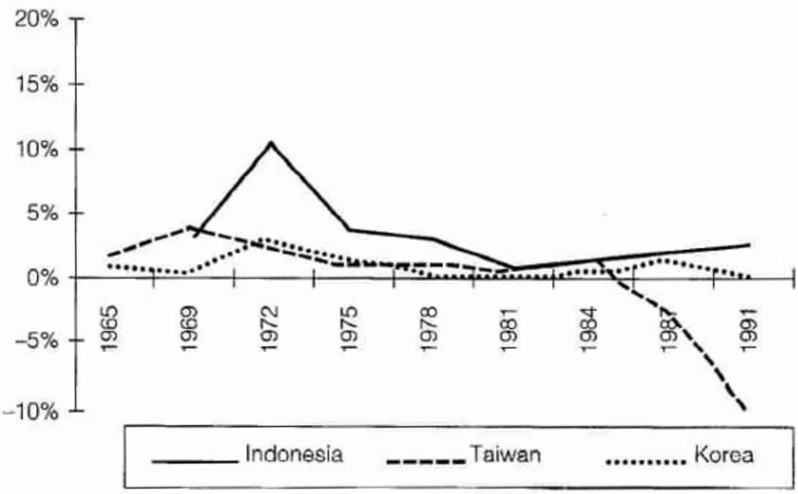


Figure 1.2 Direct foreign investment as a percentage of total investment, Indonesia, Taiwan and South Korea 1965–1991.



Source: IMF, *International Financial Statistics and Balance of Payments Statistics Yearbook*, various issues.

Note: Total investment is defined as gross fixed capital formation plus changes in stocks. The data are presented in three-year moving averages to highlight broad trends rather than annual fluctuations. Unfortunately problems with data comparability prevent the extension of the series further back than 1965.

The surge in DFI to Indonesia in the early 1970s represents the entry of 'old' and 'new' capital following the massive capital flight associated with that country's problems in the mid-1960s.

was achieved in both sets of countries, but a strong state capable of effective intervention was present in only one, there would appear to be a logical case for concluding that this particular variable was not decisive. A mild hypothesis that might be generated by this line of thinking is that the literature on the Northeast Asian developmental state is of little help in explaining the swing to export-led industrialisation in Southeast Asia. A stronger and more controversial 'revisionist' hypothesis would be that the Northeast Asian model may actually bear critical re-examination on its own terms.[7] Put bluntly, have the autonomy and capacities of the Korean or Taiwanese states in the 1960s and 1970s been overstated?

If this is one plausible response to the divergent experiences in Northeast and Southeast Asia, a second pulls in precisely the opposite direction. It is premised upon a more sceptical reading of developments in Southeast Asia thus far, and focuses as much on the limited progress in the Philippines as on the achievements of Thailand, Malaysia and Indonesia. While there can be no denying the impressive progress that has been made since the mid-1980s in Thailand, Malaysia and Indonesia in pursuing export-led industrialisation strategies, there is scope for questioning the political sustainability of this trajectory. To begin with, however, it is necessary to reflect upon the process by which major structural adjustment was in fact initiated in these countries. As Haggard and Kaufman (1992a: 18) emphasise in their comparative study of the politics of economic adjustment in developing countries: 'The central political dilemma of reform is that though significant benefits may accrue to society as a whole, policy adjustment involves significant startup costs and the reduction of rents to particular groups'. While there was of course a variety of country-specific factors involved, in Thailand, Malaysia and Indonesia externally induced economic shocks in the early- to mid-1980s appear to have been the crucial element in overcoming opposition to policy reform by those sections of the state elite and industry groups enjoying the rents created by marketing-restricting arrangements. All three countries had been reliant on commodities for the bulk of their export earnings and so the decline in global prices for key commodities, together with the impact of the international recession in the early 1980s led to sharp economic slowdowns in each of these countries. The introduction of a crisis imperative to the political equation provided the extra impetus needed to enable reform-minded technocrats in the economic ministries to prevail in policy debates within the state elite. In this they were aided by varying degrees of coalitional support from, on the one hand, industry groups and, on the other, international financial institutions such as the World Bank.

The point to be made here is not simply that the political economy of initiating fundamental economic reform differed in Southeast and Northeast Asia; more importantly, there are grounds for doubting that the progress achieved thus far in Southeast Asia is sustainable with existing political and institutional arrangements. Put simply, if the crisis imperative is removed, it is not clear that there are sufficiently robust coalitional bases of support capable of sustaining the broad policy framework which has underpinnned rapid export-led industrialisation (inter alia, stable macro prices and market-opening microeconomic reforms). This is crucial, as all of these countries still have a long way to go before they attain the levels of prosperity currently enjoyed by the Northeast Asian NICS. If, for the sake of argument, we assume that the four Southeast Asian countries can achieve a sustained average annual rate of GDP growth of 7 per cent, then, in order to reach the level of income per capita enjoyed by South Korea in 1990, Malaysia will still have to wait another 17 years, Thailand 27 years, the Philippines 41 years, and Indonesia 46 years.[8] In a situation where the state is less insulated and less coherent, in which cronyism is still prevalent and in which pressures for populist policy concessions are likely to increase, it is not obvious that the economic policy environment which has underpinned rapid export-led industrialisation can be maintained. If so, political economy developments in these Southeast Asian countries during the 1990s may well come to be seen as *affirming* rather than challenging the statist literature pertaining to the Northeast Asian NICs.

Choosing between these competing interpretations—indeed, arriving at any generalised statements about Northeast and Southeast Asia on this issue—is fraught with difficulty. An elementary empirical obstacle to parsimony is that differences in the patterns of business–government interaction *among* the Southeast Asian or the Northeast Asian countries are as notable as the differences *between* the two sub-regions during their respective periods of economic transformation.[9] Added to this, the fact that the swing to an export-led industrialisation strategy in Southeast Asia is quite recent means that some of the arguments advanced here must inevitably be considered tentative. Nonetheless, preliminary theorising is possible.

My own thoughts on this question have shifted. Whereas before (MacIntyre 1992; MacIntyre & Jayasuriya 1992b) I attached considerable significance to the fact that the experiences of the successful Southeast Asian economies during the 1980s were at odds with the literature arising from the swing to export-led industrialisation in the Northeast Asian NICs twenty years earlier, I am now less inclined to see this divergence as seriously challenging the force of the principal theoretical arguments of the Northeast Asian literature. In short, I now lean closer to the second than to the first of the two contending interpretations outlined above. The principal reason for this is the belief that the limited capacities and insulation of Southeast Asian state institutions outside the macroeconomic policy citadel of the liberal technocrats is likely to be a serious constraint on economic performance. Malaysia, Thailand and Indonesia displayed generally sound macroeconomic policies during the 1970s as well as the 1980s. In policy terms, one of the distinguishing features of the boom in manufactured exports in these countries during the later 1980s were the significant shifts in the foreign investment, trade and industrial policy regimes.[10] However, as noted earlier, these policy shifts were largely dependent upon an intervening exogenous variable—sharp balance of payments pressures. Two points follow from these observations. First, assuming that export competitiveness requires rather more in policy terms than just good macroeconomic management, then, to the extent that these countries can no longer simply rely on primary commodities as foreign exchange earners and must instead survive in the highly competitive international markets for labour-intensive manufactured goods, their foreign investment, trade and industrial policy settings are likely to be very important. Secondly, however, unless the relevant institutional arrangements and perhaps the broader political context of business–government relations change significantly, problems of government failure in these policy areas are likely to be a significant drag on international competitiveness.[11] As Haggard emphasises in his concluding chapter in this volume, 'too close an alignment between business and government can lead to capture and the adverse consequences postulated by neoclassical political economy'.

There are, of course, a range of counter arguments that could readily be advanced here.[12] For instance, although on *a priori* grounds one might expect the distribution of incentives and the problems of collective action to favour rent-seekers, the possibility of new coalitions emerging to sustain growth-promoting policies should not be overlooked. More broadly, in an environment in which capital is scarce and footloose foreign investors can choose among host countries, governments are likely to come under pressure to maintain competitive policy environments. Equally, the possibility of learning by the major players in the policy process must not be discounted; intellectual climates shift and if particular policy orientations have produced strong benefits, erstwhile opponents may come to see advantage in them. Ideas do indeed matter (Haas 1992).

Plainly there is scope for much debate here. Furthermore, I am conscious that it may be thought faintly absurd to focus on the potential problems of the successful Southeast Asian economies when they are in fact outperforming almost all the rest of the world. But better this than intellectual complacency. Sustaining a strategy of rapid export-led industrialisation *is* politically difficult. Exhaustive academic and popular discussion of the Northeast Asian NICs and the emergence of a second wave of neo-NICs seems to have obscured this fact and engendered excessive optimism. The achievements of the successful Southeast Asian economies in the 1980s are indeed remarkable and do diverge from the earlier experiences of the Northeast Asian NICs, but this does not of itself mean that the lessons about the importance of institutional configuration for economic policy (and thus economic performance) arising from Northeast Asia have lost their force. It may well be that the 1990s will provide us with a sharp reminder of this, and dispel any illusions about the political difficulties involved with pursuing sustained high economic growth rates.

STRUCTURE OF THE BOOK

The rest of this book falls into three parts. First, we present a focused theoretical debate on the role of the state in the rapid transformation of the successful Northeast Asian economies. This is an area of intense argument. Rather than trying to paper over the divisions or to present only one school of thought, the deliberate intention here is to sharpen the debate. In their essay, Trevor Matthews and John Ravenhill present a detailed and cogent case arguing that selective intervention by the state has been a decisive factor in the rapid development of some industries in the successful Northeast Asian economies. To support this claim they draw on recent work in strategic trade and strategic technology theory, as well as detailed industry-specific illustrations from Taiwan, South Korea and Japan. Matthews and Ravenhill readily accept that markets are generally efficient mechanisms for allocating resources and that government failure is a serious problem, but they attack the proposition that the opening of markets alone adequately accounts for Northeast Asia's rapid industrialisation.

In the following chapter, Iyanatul Islam argues from a different perspective, presenting a sophisticated neoclassical critique of the view that the economic achievements of the successful Northeast Asian countries are best explained by state intervention. He goes beyond the standard elements of the neoclassical position to explore the theoretical implications of recent work on Northeast Asia by political scientists and to examine critically institutionalist arguments concerning the nature of cooperation and information sharing between business and government. Islam argues for a reasoned neoclassical approach to political economy which accepts that, 'in general, the assertion that government can do no better than the market is false' (Stiglitz 1990: 37), and sees its fundamental intellectual challenge as being the task of identifying institutional arrangements that minimise both government failure and market failure.

Next, the book presents a series of detailed studies of government–business interaction in six countries: Taiwan, South Korea, Malaysia, Thailand, the Philippines and Indonesia. In his chapter on Taiwan, Yun-han Chu considers the way in which international economic pressures and domestic political changes associated with democratisation have enabled the private sector to increase its political influence. Chu notes, however, that notwithstanding the erosion of state autonomy and increase in business influence, the bureaucratic and party elite still unquestionably hold the upper hand in most key areas of economic policy. Speculating about the future, Chu discusses the possible emergence of a Japanese-style conservative coalition linking elected Kuomintang politicians and the business elite which is leading to a strengthening of the class dimension in Taiwanese politics.

Chung-in Moon's essay on South Korea examines how the pattern of relations between business and government in that country has evolved in recent years, and highlights important changes since the swing towards democracy under Roh Tae Woo. One of Moon's central themes is that the symbiotic partnership between government and business which developed under the Park regime has been replaced by a more adversarial relationship during the period since the early 1980s. Not only have politicians found it increasingly convenient to attack big business, but South Korea's large corporate groupings appear to have outgrown state subsidies that come at a price of government controls.

Among the issues Alasdair Bowie addresses in his chapter on Malaysia are the moves made in the early 1980s by the Malaysian government to replicate what it saw as a Korean model of state-led industrial deepening. The centrepiece of this strategy was the building up of state-owned enterprises. This was not designed solely to bring about industrial change; an equally important objective was the redistribution of resources to indigenous business people as distinct from the well-established local Chinese business community, as part of wider moves to manage ethnic tensions. However, as Bowie explains, the move achieved only limited success, and by the mid-1980s deteriorating economic circumstances forced the government to rationalise and privatise elements of the SOE sector. Notwithstanding the efforts of the Malaysian government to emulate South Korea, Bowie emphasises the marked differences between business–government interaction in Malaysia and Northeast Asia: the Malaysian state was able to achieve only very modest success with its attempts at selective industrial targeting; the state did not enjoy effective insulation from business and other societal pressures; and there was extensive reliance on foreign investment. In an interesting conclusion which runs counter to usual expectations, Bowie argues that political exclusion along with clientelism and cronyism are in fact increasing rather than decreasing in Malaysia.

In his chapter on Thailand, Anek Laothamatas highlights the shift from an hierarchical patron–client relationship between government and business to one in which business now enjoys a more equal footing, with organised private sector interests developing a major voice in the policy process. This has been achieved by business people moving to supplement the traditional repertoire of personalised clientelistic links with individual members of the state elite, by contesting parliamentary elections, supporting industry-specific group action, and participating in peak-level liberal corporatist arrangements for serious policy consultation between government and industry. In a theme echoed in the chapters on Malaysia and Indonesia, Anek argues that the business–government relationship in Thailand differs markedly from most accounts of Taiwan or South Korea in two key respects: business has enjoyed more extensive influence over policy and corruption has been quite extensive.

The Philippines provides a striking contrast with all the other countries covered in this study. In his essay, Paul Hutchcroft graphically highlights the way in which the Philippines state has been swamped by the particularistic demands of crony business people. Internally fractured and enmeshed by webs of clientelistic ties, the state has been unable to take decisive policy action—either in the direction of effective interventionist policies or of neo-liberal-style market-opening reforms. Democratisation has brought little improvement. While the Aquino administration dismantled some of the large rent-taking arrangements enjoyed by crony firms linked to the Marcos regime, the pattern of clientelistic links between business and government—or 'booty capitalism' as Hutchcroft aptly describes it—was not fundamentally altered. Instead, the doors to government were effectively opened further, permitting a wider range of business leaders to seek preferential access on a somewhat more competitive basis. Looking to the future, Hutchcroft speculates that the military withdrawal of the United States from the Philippines may be a catalyst for longer term change, as US assistance has underpinned the survival of an otherwise almost incapacitated state.

The picture of business–government relations in Indonesia which emerges from Andrew MacIntyre's chapter is one which features gradual change; and again it contrasts with the experiences of Taiwan and South Korea. Despite being economically interventionist and politically repressive, the Indonesian state cannot be considered strong in this connection. Business associations have been effectively contained and controlled within an authoritarian corporatist framework, but a pervasive network of clientelistic relationships has ensured that leading Indonesian firms (nearly all run by Chinese Indonesians) have been able to advance particularistic demands. Beginning in the late 1980s and driven by external economic pressures, changes have begun to emerge as the state has drawn back from widespread market interventions and, simultaneously, parts of the private sector have grown more assertive and begun to mobilise effectively for political action. But these developments co-exist uneasily with the enduring pattern of high level clientelistic links between top business and political figures.

Finally, in his concluding essay Stephan Haggard draws together various strands running through the preceding chapters in the context of a re-examination of established ideas about the political economy of rapid export-led industrial development. Haggard begins by highlighting four aspects of policy which have been essential elements in the economically successful Northeast and Southeast Asian states: relatively stable macro and exchange rate policies; free labour markets; dualistic trade policies that are protectionist for final goods, but provide access to industrial inputs at world market prices; and coherent industrial policies. He then presents an institutionalist account of the nature and significance of business–government relationships in Northeast and Southeast Asia, laying stress on three major themes. First, the coherence of economic policy depends on the nature of the political institutions structuring relations between business and government. Secondly, these institutional arrangements are themselves shaped by developments at critical moments in the wider political relationship between the public and private sectors. And, thirdly, in all of the countries under consideration here the private sector is becoming increasingly well organised for political purposes.

Reflecting on the broader question of the theoretical significance of the economic achievements of successful Southeast Asian countries, Haggard notes the existence of some important differences between Northeast and Southeast Asian experiences as well as the need for some qualification of the Northeast Asian literature. But he argues that key elements of this literature remain intact. Haggard concludes by identifying topics for future research, one of which is the impact of the growing political influence of organised business on economic policy and economic performance. Questions of this sort are most usefully approached in the light of comparisons with other industrialising countries. We hope that this volume will facilitate second-generation research of this sort by helping to pioneer cross-regional comparative political economy work on Asia.

NOTES

1 I am grateful to Richard Doner, Stephan Haggard, Paul Hutchcroft, Jamie Mackie and John Ravenhill for helpful comments on an earlier draft of this chapter.

2 Doner (1992) provides a comparative study of the development of the automobile industry in South Korea and four Southeast Asian countries. Clark & Chan (1992) and Langford & Brownsey (1990) offer more broadly based comparisons of Northeast and Southeast Asian experiences, though in a less theoretically coherent fashion. The boldest and most interesting comparative study is Doner & Hawes (forthcoming) which critically examines contending theories about the political economy of growth in Northeast and Southeast Asia. Economists have moved rather more quickly than political scientists in undertaking comparative studies in this area; see James et al. (1989), World Bank (1993).

3 Inevitably, some detail is lost in generalised surveys of this sort. For useful discussions of time- and sector-specificity dimensions to state strength, see Kim & Huang (1991), Kim (1988) and Shafer (1990).

4 Additionally, the South Korean and Taiwanese states were of course 'structurally' constrained by the basic and long-term needs of business.

5 This pattern has to a considerable degree faded in Thailand, where ethnic divisions have been blurred to a much greater degree than in Malaysia or Indonesia (Mackie 1988; Skinner 1957b).

6 It should be noted that this has taken place at a time when there has been a global trend toward market liberalisation. Significantly, this trend has been actively encouraged by multilateral and private lending agencies. Whether or not it proves enduring remains to be seen. Doner & Hawes (forthcoming) argue that there are many emerging collective action problems (for instance, technological upgrading) which are likely to require effective state intervention.

7 Doner & Hawes (forthcoming: 24–25) have begun to explore this possibility, arguing that the role of industry associations in contributing to the processes of policy reform and industrialisation in South Korea and Taiwan may have been significantly underestimated in the existing literature.

8 This rudimentary projection is based on compound growth calculations using World Bank (1992b) data on GNP per capita for 1990, and assuming a standard rate of 2% population growth across all four countries.

9 Three illustrations will suffice here. SOEs account for a substantial share of economic activity in Taiwan and Indonesia, but are much less important in Thailand, the Philippines, Malaysia and South Korea. DFI accounts for a sizeable chunk of gross capital formation in Malaysia, Thailand and the Philippines, but much less so in South Korea, Taiwan and Indonesia (even though the latter is much more open to DFI than previously). And, thirdly, the formal structures for peak level business representation in Indonesia, Taiwan and South Korea are subject to substantial government influence; but this is much less the case in the Philippines, Malaysia and Thailand. In short, there are serious empirical obstacles lying in the way of the achievement of neat and tidy region-based explanations.

10 A statement of this sort requires qualification. Export competitiveness and, more broadly, overall economic growth obviously cannot simply be reduced to investment, trade and industrial policy settings (although I would argue that they are particularly important). In addition to macroeconomic policy, other factors which also need to be taken into account are global economic conditions, local labour market conditions, the scope for growth on the basis of domestic expansion, and the ability of local firms to access and master new technology.

11 This assumes that external shocks do not continue to occur at timely intervals and thereby provide the necessary discipline for policy.

12 I am grateful to John Ravenhill for helpful comments in this area.

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2 Strategic Trade Policy: the Northeast Asian Experience

Trevor Matthews and John Ravenhill

Few observers would have ventured to predict in the early 1950s that, within three decades, Japan, South Korea and Taiwan would be among the world's most dynamic industrialised economies. In terms of labour productivity, growth in manufactured exports, share of income derived from manufacturing, or growth in gross national product per person, the economic performance of these Northeast Asian market economies over the last forty years has been exceptional. 'Never before in human history', writes one economist, 'have economies grown as fast for so long as in Northeast Asia over the past four decades' (Garnaut 1989: 36). To another economist, 'what has happened in capitalist East Asia during the postwar era is as close to a jump up the economic hierarchy of nations as nature ever makes' (Wade 1990: 4).

Particularly spectacular has been the success of these economies in producing skill-intensive, high-value-added products that are competitive in cost and quality on world markets. Well known is Japan's success in exporting cars, television sets, audio equipment, facsimile machines, video cassette recorders and random access memory chips. So also is Taiwan's and South Korea's export success in heavy industry products such as steel and ships, and in high technology products such as microwave ovens and machine tools. As the 1990s began, Korea was the world's largest shipbuilder, it ranked as the world's third biggest manufacturer of large capacity memory chips, and it possessed an automobile industry that appeared poised to join the world's top producers. And Taiwan was making its mark in microelectronics, notably in producing personal computers and computer add-ons and in designing large scale integrated circuits.

The rapid and spectacular economic achievement of the three

Northeast Asian economies has attracted world attention. Library shelves now sag with studies describing and analysing the Northeast Asian experience and drawing the policy lessons for other countries. One question in particular runs through many of these studies: is Northeast Asian industrialisation principally to be explained by interventionist government policy or is it best explained by the untrammelled free play of market forces? According to one school of thought, the Northeast Asian successes are the result of consciously planned strategies of export-led growth pursued by 'developmental states'. A central feature of these policies has been the targeting of 'strategic' industries for special assistance on the basis of their perceived potential for promoting economic growth, rapid technological change and international competitiveness. According to this interpretation, although industrialisation has been export-oriented, it has not always embraced free trade. Import controls have on occasion been used, along with other forms of industrial assistance, to engineer a competitive advantage for the targeted industries in global markets. To writers in this school, the remarkable success of the Northeast Asian economies is evidence that selective industrial policies to foster targeted industries do indeed work (Amsden 1990; Dosi, Tyson & Zysman 1989; Johnson 1987; Tyson & Zysman 1989; Wade 1990).

A second school of thought, in contrast, views the outstanding performance of the Northeast Asian economies as vindicating liberal prescriptions drawn from neoclassical economics. In the opinion of this group, the Northeast Asian economies conclusively demonstrate that freeing up the economy and conforming to market prices, both domestic and international, are the keys to economic success (Krueger 1985; Naya 1988; Saxonhouse 1983; Tresize 1983). They concede that *some* interventionist policies may actually have assisted industries to prosper, but these policies all have one feature in common: they have been market-conforming. In all other cases, industrial targeting has at best been marginal in its effect and at worst actually detrimental to national economic performance. In arguing the ineffectiveness of activist industrial policies, these neo-liberal economists make much of a number of well-publicised cases where Northeast Asian governments are said to have signally failed to pick industrial winners. Some of them have been particularly keen to refute claims that interventionist policies based on what has become known as 'strategic trade theory' have been a key factor in contributing to the export success of the dynamic Northeast Asian capitalist economies.

In taking issue with economists who deny that strategic trade policy has been important in explaining the economic success of the Northeast Asian market economies, we wish to emphasise three points about our position. First, we do not intend to convey the impression that strategic trade policy has been the only factor that accounts for the dramatic economic performance of these economies. Indeed, we can quite comfortably accept the assertion that strategic trade policy has been neither necessary nor sufficient for the success of *all* industries in *all* Northeast Asian countries at *all* stages of their postwar growth. What we do argue though is that strategic trade policy has been *decisive* for the success of *some* industries in *some* countries at a *certain* stage of their economic development. Neo-liberal critics of strategic trade policy must debate the issue at that level of particularity. It is quite beside the point for critics to point, for instance, to Hong Kong as if the existence of a 'laissez-faire' Hong Kong constituted a refutation of the claim that state intervention has played a decisive role in *other* countries at certain stages of *their* development.

Second, in arguing that the governments of the Northeast Asian economies have effectively employed strategic trade policies to help a succession of industries to become world class competitors, we do not deny that policy failures have occurred. But we believe that it is not sufficient for the critics of strategic trade policy to point to individual cases of policy failure as conclusive evidence that selective policies have been inimical to sectoral or national growth. Policy failures must be seen in perspective. How frequent and typical are the failures? Do the failures outweigh the successes? By what criteria is a policy measure deemed to have failed? Is failure to be assessed in terms of static efficiency (whether the policy failed to allocate resources to their most efficient current use) or in terms of dynamic efficiency (whether the policy failed to promote economic growth and technical innovation)? Even if dynamic efficiency is the criterion, how should failures be interpreted? As Wade (1990: 31) asks: 'If industries which receive a lot of assistance grow more slowly than those which do not, does this indicate the failure of assistance or does it indicate targeting of industries that need assistance as a condition of subsequent fast growth?'. On these questions we believe it is appropriate to take the longer term perspective.

Third, in the absence of testable counterfactuals we also believe it is appropriate to rest our argument on a presumption, one that is disputed by some economists (Krueger 1985; Naya 1988). Here we follow Robert Wade. In his magisterial study of the role of government in Northeast Asian industrialisation, Wade (1990: 305–6) concluded that the 'balance of presumption' must be that the various industrial and trade policies helped more than hindered economic growth: 'To argue otherwise is to suggest that economic performance would have been still more exceptional with less intervention, which is simply less plausible than the converse'.

This chapter examines one aspect of relations between government and business in Japan, South Korea and Taiwan: the strategic use of trade policy. The first section depicts the range of thinking to be found under the rubric of strategic trade theory. Most discussions of strategic trade theory have attempted to evaluate it within a partial or general equilibrium framework using calibrated models. We suggest that such approaches neglect an important body of literature on international trade that places at the centre of its analysis the dynamic and cumulative impact of technological change and innovative capacities on inter-country competitiveness and economic growth. We label this the 'strategic technology approach'. The second section argues that the three Northeast Asian governments have used trade (and industrial) policies strategically and effectively in order to create competitive advantage for selected capital-intensive and high technology industries. Evidence is drawn from the extensive case study literature dealing with these targeted industries. This evidence, we contend, fits better the interventionist rationale of strategic trade theory than it does the market-following rationale of neoclassical trade theory. The third section considers the political and institutional factors that have allowed these Northeast Asian governments to avoid most of the pitfalls of 'government failure'. The chapter concludes by canvassing some of the lessons that other countries can learn from the Northeast Asian cases.

'STRATEGIC TRADE' AND 'STRATEGIC TECHNOLOGY': RECENT THEORIES

The orthodox theory of international trade rests on the doctrine of comparative advantage. This doctrine, developed early last century by the English economist David Ricardo and elaborated by the Swedish economists Heckscher and Ohlin, explains trade between countries by reference to their relative endowments of factors of production. Countries will export goods that make intensive use of their relatively abundant factors; that is, goods in which they have a comparative advantage. Although based on a number of strict assumptions—perfect competition, given and freely available technology, and the absence of economies of scale—neoclassical theory provided a plausible explanation of situations where raw materials were traded for manufactured products.

Over the last two decades, however, economists have recognised that orthodox trade theory has not been able to explain the rapid growth of intra-industry trade in the period since the Second World War. This has occurred between countries with similar factor endowments and has often involved the exchange of products that are differentiated primarily by brand name, for example trade between Sweden and Germany in BMWs and Volvos. Not only that, but much of this intra-industry trade occurs within industries characterised by oligopoly, is generated by technological innovation, and has little to do with relative endowments of factors of production. In these circumstances, the assumptions of the orthodox theory of international trade appear, to quote one of the pioneers of strategic trade theory, 'to do a major violence to reality' (Brander 1987: 10).

Economists have also increasingly recognised that the orthodox theory leaves out the *strategic* aspects of trade. In an oligopolistic industry a firm's position in the marketplace will depend on its interaction with others—where there are only a limited number of firms in an imperfectly competitive market then the profit of one company will be determined in part by what its rivals do. Firms therefore may be able to improve their position by acting *strategically*. They may deliberately act to shape the choices available to their rivals and thereby to influence their rivals' behaviour. This is the sense in which the word strategic is used in the sense in which it is employed in modern industrial organisation theory—that is, to describe an action which is undertaken not because it is immediately profitable in itself but because of the anticipated impact that it will have on actual or potential competitors. Helpman and Krugman (1989: 5–6) cite the example of investment in excess capacity which a firm does not intend to use, but whose presence deters potential competitors from entering the market. Who moves first, who makes the most credible commitment and who is able to deter rivals from entering the field—all may play a decisive role in determining profits. We enter the realm of game theory where the structure of the game becomes of primary importance (Dixit & Kyle 1985).

These notions of strategic behaviour in imperfectly competitive markets provided the foundation for the new theories of trade. A starting point was the recognition that countries specialise in producing different products for reasons that often have less to do with relative factor endowments than with the advantages that established firms gain from being the first to occupy a particular sector. Among these 'first mover' advantages is a firm's ability to reduce average and marginal costs of production by manufacturing large quantities of a given product ('economies of scale'), to improve production techniques through practice over time ('learning by doing') and to establish a recognised brand name that differentiates its product from those of competing firms. Advantages of this sort, combined with the often large capital investments that newcomers would face, are powerful deterrents to potential new entrants to an industry. In such situations of imperfect competition, oligopolistic firms may be able to earn abnormal profits ('rents') even in the medium to long term.

Three distinct strands of strategic trade theorising have been developed within mainstream economics. The first is based on game-theoretic considerations of strategy and credible commitments. The second builds on notions of increasing returns to scale, and is an elaboration of traditional arguments for infant industry protection. The third focuses on rents and externalities. In addition to these three strands, all of which lie within the mainstream framework, a fourth line of reasoning has been developed which builds on the literature on technological change. We refer to this last strand as the strategic technology approach.

Credible commitments

Strategic trade theorists built on the logic of imperfect competition by suggesting that government action may assist firms to capture rents. As governments controlled instruments, such as tariffs and subsidies, that were not available to the private sector, government intervention might enable firms to make commitments and to undertake other strategic moves that would otherwise not be credible deterrents to potential rivals. Government intervention might also improve the profitability of domestic firms. In addition, by helping to shift rents from foreign to domestic firms, it might also increase the welfare of the nation. This new model recast the traditional positive sum depiction of international trade into a prisoner's dilemma game. As Brander (Dixit & Kyle 1985: 9) asserted, under this new model 'even though free trade may be a good policy for the world as a whole, individual countries may be able to gain unilateral advantages from interventionist policies'. With substantial economic rents available for capture, governments could be tempted into beggar-thy-neighbour policy games. By acting strategically, governments could engineer comparative advantage for their domestic economies. The very structure of international trade could be shaped by such intervention.

The original development of strategic trade theory by the industry economists Brander and Spencer (1981) suggested that government action can alter the strategic game played by domestic and foreign firms by offering a subsidy to the domestic firm. An export or production subsidy, by effectively lowering costs, may enable the domestic firm to expand production and gain market share at the expense of its overseas rivals. The subsidy may deter foreign firms from competing for lucrative markets; the rents available in that industry will thus accrue to the domestic firm and, more generally, to the domestic economy. The theory demonstrates that a government can, through predatory policies, raise national welfare at the expense of that of another country. The classic example that is often given is the subsidies provided by European governments that enabled the Airbus consortium to enter the market for large capacity jet aircraft.

Once the principle of government intervention to help firms to capture rents was established, other possible modes of intervention were easily identified. All of these revolved around the ability of governments to make a credible commitment in support of their domestic firms; governments might budget funds for support of a firm's research and development, might publicly promise future protection for a firm's product, or publicly commit themselves to retaliation should a foreign government provide subsidies or protection to its domestic firms (see Dixit & Kyle 1985 for a discussion of the possibilities).

Realising economies of scale

Krugman (1984a) extended the strategic trade idea by suggesting that protection of the domestic market may assist a domestic firm by lowering its production costs. The assumption here is that the industry is characterised by economies of scale whereby unit costs of production fall as output increases. If a government closes off its domestic market to foreign competition the domestic producer will enjoy longer production runs than would otherwise be the case and thus reap economies of scale. These 'static' economies may be reinforced by the firm's ability to 'learn by doing'. The lower production costs that are gained from exploiting a protected domestic market may then enable the domestic producer to compete more effectively in foreign markets.

Rents and externalities

If the intention of strategic trade policy is to capture rents then the significance of government intervention clearly rests on the scope and magnitude of the rents available. Trade economists have traditionally assumed that competition—if not from other domestic firms then from overseas rivals—will soon erode any rents that are being earned. Often they assume a considerable homogeneity of products such that one can easily substitute for another. Industry economists—working closer to the coalface—have been less convinced. For some, the proliferation of brand name products originating from a small number of companies suggests a widespread existence of 'mini-rents' in the economy which cumulatively add to significant amounts (Lipsey & Dobson 1987).

Estimating the extent of industry rents is particularly difficult in that some of the abnormal profits may not show up in firms' accounting statements as profits but be retained within the firm and utilised for new investment, employment of new staff, increased research and development expenditure, etc.—the very elements that strategic trade advocates see as providing an advantage to oligopolistic firms. Studies that rely on reported after-tax rates of profits for firms in estimating rents thus may fail to capture the concept. Attention has focused in particular on the possibility that a large portion of industry rents may not go to shareholders but may instead be captured by labour. Evidence in support of this proposition is provided by studies that show that there are significant differences in the wages paid to labour for the same type of job in different sectors of the economy—and that these differences between industries are consistent across time and across countries and are found at all levels of occupation (Dickens & Lang 1988; Dixit 1988; Katz & Summers 1989; Lipsey & Dobson 1987; Thaler 1989).

As the debate over the significance of rents—for countries, if not for individual firms—has remained inconclusive, some economists (for instance Baldwin 1992; Krugman 1987b; Krugman 1992) have suggested that the importance of strategic trade policy lies not so much in the potential for capturing rents but for generating externalities. Positive externalities refer to benefits for other sectors of the economy generated indirectly by a firm's activities. Following Viner (1931) and Scitovsky (1954), economists have distinguished between pecuniary and technological externalities. Pecuniary externalities are those that are transmitted through market transactions; that is, through the prices of inputs and outputs of other firms. Technological externalities refer to benefits that are not transmitted through market transactions. Such benefits include, for instance, the diffusion of technical knowledge that cannot be completely appropriated by the firm undertaking the research and development. In this sense, research and development (R&D) activities produce public as well as private goods.

The fact that technological advances can be readily copied deters companies from investing in R&D. As with other public goods, the market tends to underinvest in R&D. Studies have suggested, for instance, that early innovation in the computer industry was far slower than it might have been because the social returns to innovation greatly exceeded the private returns to computer manufacturers (Bresnahan 1986; Trajtenberg 1989).

In the strategic trade theory context the externalities problem took on a new importance. First, strategic trade theory focuses on high-technology, imperfectly competitive industries where externalities are likely to be more prevalent. Robert Baldwin (1991: 42), a leading international trade theorist, comments that 'recent empirical evidence indicates that knowledge spillovers associated with research and development efforts seem to be more significant than most traditional trade economists thought' (for evidence on the magnitude of externalities see Bernstein and Nadiri 1988; Jaffe 1986; and Levin et al. 1987). Second, strategic trade theory suggests that those governments that fail to take measures to overcome the market failures that produce externalities will disadvantage their own domestic firms in global competition.

Krugman (1992: 438) has recently emphasised how extensive externalities may be. He asserts:

> What the new theory tells us is that meaningful externalities occur not only when there are direct technological spillovers, but in any situation in which there are increasing returns and [where] market size matters. That means almost everywhere. In other words, the marginal social benefit of a dollar's worth of resources is not, as conventional theory would have it, equal in all activities except for a few exceptions. Divergences between social rates of return are pervasive. There are good industries and bad, good jobs and bad, and the optimal policy is to subsidise the good and tax the bad.

Despite the economic dynamism implicit in the concept of externalities, they have been treated within a static framework by most economists who have participated in the debate over strategic trade theory. The reason is that the models employed by these economists are cast within partial or general equilibrium frameworks that simply do not accommodate either the cumulative benefits that dynamic externalities may have for other industries, or the gains from learning by doing. As a consequence, some of the most celebrated models that are frequently cited as reasons for rejecting the policy implications of strategic trade theory—most notably the cost–benefit analyses made by Baldwin and Krugman (1988a; 1988b) of European subsidisation of the Airbus consortium and of Japanese government measures in support of its semiconductor industry—fail to address some of the most significant issues raised by the strategic trade theory literature. In particular, they ignore any rents that accrue to the labour force from employment in more highly skilled jobs, and they ignore the externalities that may benefit associated industries. Their results are also heavily dependent on the assumptions concerning the values of key parameters built into the 'calibrated' model.[1]

In more recent work, Richard Baldwin (1992) has taken some of these criticisms on board. In a study of Brazilian government support for the production of a commuter aircraft, the EMB-120, Baldwin found that his calibrated model, when using conventional assumptions, showed that the subsidy led to a net welfare loss, whereas when labour rents or spillovers in the form of skilled human capital formation were included, the subsidised project produced net welfare gains. As Baldwin (1992: 209) concludes, participants in a high-tech project are likely to acquire skills that are beneficial to the economy and outlive the project itself. In other words some of the subsidy may be capitalised in the form of human capital. Training and experience that could have been gained only from actually undertaking the project (learning-by-doing), and that is beneficial to the economy in ways that extend beyond the project itself, should be treated as an investment. As Baldwin (1992) himself concedes: the return on this investment should be appended to the plus column of the cost–benefit accounting'. There are of course innumerable other spillovers that are for the most part extremely difficult to measure.

Somewhat ironically, Baldwin in this work continues to cite without qualification the results of the earlier studies co-authored with Krugman, and fails to acknowledge that these studies would be affected by exactly the same types of externalities he lists as affecting the Brazilian case. The importance of such externalities has yet to be acknowledged by most economists.[2]

THE STRATEGIC TECHNOLOGY APPROACH

Dissatisfaction with the way in which most international trade theorists have treated the role of technological change has led other economists to propose an alternative to the new trade theory. This alternative approach has its roots in the literature on economic development; in particular, the literature on technological innovation and adaptation. We will refer to this approach as the 'strategic technology' school.[3]

It is true that some of the contributors to the new trade theory have attempted to incorporate the view that technology is an endogenous factor that partly explains the pattern of international trade. Krugman (1990) points out that there is a 'natural alliance' between strategic trade theory, with its emphasis on increasing returns and imperfect markets, and the view that technological change is a key factor driving international specialisation. This is because technological development is normally associated with increasing returns in imperfectly competitive industries, and because the most important sources of increasing returns probably derive from dynamic learning economies and R&D. Grossman and Helpman (1991) as well as

Krugman (1990) have developed dynamic models of trade in which technological change is treated as endogenous and as having permanent effects on trade specialisation. In other words, their models recognise the possibility that a country that fails to innovate may suffer an absolute as well as a relative decline in its standard of living. But these models are couched in general equilibrium terms and assume that technology is freely available to and easily adapted by individual firms.

These assumptions are rejected by the strategic technology school. Its adherents deny that technology is essentially a body of readily codified and perfectly tradeable knowledge, as is to be found in a freely available blueprint or training manual (Nelson & Soete 1988: 633). Instead, they emphasise two interconnected properties of technological knowledge: that it is characteristically specific in application and cumulative in development. It is specific in that much innovation is particular to a product or a production process; often, indeed, specific to one firm and to the localised and tacit experience of its employees. It is cumulative in that it is path-dependent, often involving a process of 'creative accumulation' where the new builds on the old (Pavitt 1986: 45). In that sense, the rate and direction of technological change cannot be fully understood in terms of market signals. Much is driven by the logic of the technology and the accumulated experience of those who have been using and adapting it. For that reason, transferring and exploiting technical and scientific information necessary for innovation can be costly and complex.

The cumulative nature of technological development means that the development and application of key technologies will not just have a one-off effect on the economy but may set the country on to a new and possibly irreversible technological trajectory. Again the emphasis is on the importance of historical 'first mover' advantages and on the nature of industrial specialisation. Early developers, it is argued, may be able to practise what Arthur (1989) calls 'competitive exclusion': that is, their gains from scale and learning economies may be of a sufficient magnitude as to deter others from entering the industry. Early entrants into an industry may benefit from a virtuous circle of innovation, economies of scale, learning by doing, and oligopolistic exploitation of technological leads, which in turn gives countries internationally competitive economies. On the other hand, economies that fail to innovate or successfully adopt technologies may be condemned to a perverse cycle which sees them specialising in raw materials or standardised products for which the market is growing slowly. One outcome can be the emergence of technology gaps between countries. These gaps (corresponding to absolute advantages), the strategic technology school asserts, are more important than comparative advantage in explaining patterns of international trade (Dosi, Pavitt & Soete 1990, chs 6 and 7).

With the acquisition of technology being the key determinant of a country's growth trajectory, there is in the strategic technology literature a central role for governments to implement selective measures which foster the development and application of new technologies. Here particular emphasis is given to 'leading' industries, ones that 'drive and mold economic progress across a broad front' (Nelson 1984: 1); in other words, industries that generate pervasive technological externalities for a broad spectrum of other sectors. In promoting these industries, Dosi, Pavitt and Soete (1990) suggest, firms and governments may have to choose between three types of efficiency: 'Ricardian efficiency', the neoclassical idea of distributing existing factors of production in a manner which generates maximum profits; 'Keynesian efficiency', the maximising of future profits through investing in goods and industries which have the greatest growth potential in international markets; and 'Schumpeterian efficiency', the allocating of resources to maximise the possibilities for innovation and technological dynamism.

Governments, it is argued, should intervene to promote future national welfare by fostering Keynesian and Schumpeterian patterns of efficiency. The targets should be industries judged to be in the country's long-term comparative (and absolute) advantage, those whose products have high income elasticities of demand. Nelson (1984) terms them 'strategic' industries, for it is upon their strength that a country's economic progress and its international competitiveness depend. Two concepts of 'strategic' are thus interwoven in the strategic technology literature. The first is the idea that there are some industries deserving of support because of the strategic economic advantages they confer on the nation. The second is the game-theoretical concept of 'strategic'—the initiation of moves designed to give advantage to one's own domestic producers.

But why should government intervention be necessary? Why would a rational profit-maximising firm not pursue Keynesian and Schumpeterian efficiencies? The answer lies in market imperfections. First, imperfections in capital markets can give rise to 'short-termism'—the desire to see immediate high returns on investments. This myopia may derive from the structure of capital markets. In countries where companies are more dependent on equity than on long-term bank lending to finance major investment projects, corporate managers will be under pressure from their shareholders to deliver high returns in the short term. It may also derive from the highly uncertain and risky nature of high technology R&D, and the tendency of the market to discount heavily the possibility of future profits from technological breakthroughs. Uncertain about the technological feasibility of a project and the time it will take, about its total cost and about the commercial viability of the planned new product, private capital markets are often unwilling to invest in high technology R&D. This unwillingness will be the greater if a country lacks a vigorous market in venture capital. Second, in imperfect product markets characterised by increasing returns current market signals can be misleading indicators of future profitability (Dosi, Tyson & Zysman 1989: 17). Third, as Scitovsky (1954) pointed out, underinvestment from market failures also occurs because market signals do not reflect the 'untraded interdependencies' that exist among investment decisions when reciprocal externalities are present. Future profits in one industry may be inseparable from the successful establishment of another industry and vice versa—but as the market does not consider the two together the necessary investments are not made.

For members of the strategic technology school, the possibility that market signals may fail to yield socially optimal outcomes for the nation is a strong justification for government intervention to target 'strategic transformative' technologies. Under such circumstances, they argue, it may be necessary to trade Ricardian efficiency for Schumpeterian efficiency. For the targeting of strategic industries, even if it is temporary, may have permanent effects on the future trajectory of a country's economic development and its technological progress. Japan's policies to promote high technology industries have been motivated, they claim, by just such a Schumpeterian perspective (Dosi, Tyson & Zysman 1989: 23, 33).

NORTHEAST ASIA: SECTORIAL EVIDENCE

This section examines the ways in which the governments of Japan, South Korea and Taiwan have protected and promoted selected capital-intensive and high technology industries. It argues that the evidence—much of it drawn from industry case studies—is more consistent with the interventionist rationale of strategic trade theory than it is with the market-following rationale of orthodox trade theory. Indeed, much of the evidence is consistent with an interpretation that suggests these governments have deliberately used trade and industrial policies not only to engineer a competitive advantage, but also to secure for the domestic economy an absolute technological advantage, in products seen as holding the key to future competitiveness.

Japan

The two decades preceding the 1973 oil crisis were the years in which the Japanese government actively intervened to promote rapid industrialisation. In this pursuit the government was assisted by a political consensus in favour of rapid growth, ample opportunity to catch up with the West, a liberal trading regime that gave Japan access to overseas markets, a capital market insulated from international money markets, and access to dependable and cheap supplies of raw materials and energy—especially oil. Under this policy, the Ministry of Finance channelled finance to the large city banks, encouraging them to provide low cost capital to the industries judged to be basic to sustained economic growth. The capital was to enable the recipient firms to adopt the most efficient mass-production technologies and so to reap the benefits of a declining long-run average cost curve. To prevent the ensuing investment race from degenerating into 'excessive competition', the Ministry of International Trade and Industry (MITI) coordinated the pace of investment, formed price-fixing cartels and protected the domestic industries from foreign competition. The protected local market became the export platform for the ever-increasing domestic production that flowed from the race to invest (Yamamura 1986). Among the most important beneficiaries of these policies were the iron and steel, automobile, machinery and colour television industries.

Many of the conditions underpinning the high growth period disappeared in the years following the oil crisis. Environmental concerns undermined the pro-high-growth consensus as did the increased vote for the opposition parties; capital liberalisation reduced the ability of the Ministry of Finance to control the money market; international pressures, including Japan's membership in GATT and the OECD, forced MITI to reduce tariff and quota barriers; and technological parity with the West ended Japan's ability to rely on American and European experience in picking winners. MITI's task was now to *make* winners. Its attention turned to promoting high technology industries, especially the semiconductor and computer industries. While the policy instruments at its disposal were very different from those available in the high growth decades, the general aim of its promotional policies remained the same: to advance Japan's industrial structure so as to maximise its gains from trade (Itoh et al. 1991, chs 2, 3, 7).

Steel

Promotion of the steel industry lay at the heart of Japan's postwar program of 'heavy and chemical industrialisation' (Imai 1980;

Magaziner & Hout 1980; Yamawaki 1988). In 1950 the Japanese Cabinet instructed MITI to devise a policy for the development of a modern and internationally competitive steel industry. A five-year rationalisation plan (1951–1955) ensued. Under that plan and its successor, MITI (and the Ministry of Finance) intervened directly to boost the capital that the industry had for investing in the most advanced steel-making technology. The government did so by: using its influence over the banking system to ensure that ample capital was made available to the industry at favourable rates; providing steel companies with generous depreciation allowances and exemptions from property taxes; subsidising the construction of deepwater ports adjacent to the coastal steel mills to accommodate giant ore and coal ships; allocating scarce foreign exchange to the industry for the purchase of the latest equipment and technology from abroad; and extending preferential low interest loans to the industry through the Japan Development Bank (JDB) and the Long-term Credit Bank. The subsidised JDB loans also acted as a green light to other lenders. Although governmental subsidies declined in importance after 1960, the government continued to guarantee much of the private lending. Investment poured into the industry, resulting in a phenomenal increase in gross crude steel capacity. Howell et al. (1988: 193) describe the leap in capacity from 28 million metric tons in 1960 to 148 million metric tons in 1975 as 'the largest expansion in such a time frame in the history of the world steel industry'.

MITI also influenced the direction and form of this investment. It also ensured that the principal Japanese producers adopted the latest technologies. Through its controls over technology imports, for example, MITI was largely responsible for the industry's early adoption of the basic oxygen furnace (BOF) technology, allowing production costs to be cut by some 20–40 per cent. To ensure that this Austrian technology was disseminated to other firms, MITI arranged for one company, Nippon Kokan, to import the technology and for the other companies to share the royalty costs in return for their having access to it (Howell et al. 1988: 199). This case illustrates MITI's method of keeping royalty costs down. By permitting only one firm to bid MITI enhanced the bargaining power of the purchaser, enabling Japan to import the technology at lower prices than those paid by some other countries. According to one estimate, Japanese producers paid 1 cent per ton for the BOF technology compared to 35 cents per ton paid by American steel producers (Goto & Wakasugi 1988: 190).

MITI moreover was determined that Japanese mills be of optimal size to exploit the economies of large scale characteristic of the industry. In targeting the industry, MITI favoured the very largest firms. Under the first rationalisation plan, 71 per cent of government funds flowed to only four of the forty-four steel firms (McCraw and O'Brien 1986: 96, note 40). It feared that, left to themselves, competition between the six major steel companies would result in an excess of new projects below the optimum size. To prevent this form of market failure, MITI encouraged a system of investment coordination among the largest companies to enable them to 'take turns' in building completely new integrated mills (Howell et al. 1988: 215–18; Imai 1980: 206–12) As a result of this official encouragement of huge new 'greenfields' facilities, especially at seaboard locations to take advantage of new sources of iron ore and coal shipped in from Australia and Brazil, Japanese mills were soon among the largest and most technologically advanced in the world. American producers, by contrast, lagged in the adoption of the new technologies, preferring 'piecemeal innovation'—the strategy of upgrading existing production facilities rather than investing in wholly new facilities. Indeed, by the mid-1970s Japan led the world in the use of large capacity furnaces, BOF furnaces, continuous casting techniques and computer-controlled production processes. The average capacity of an integrated Japanese plant had by then reached 7.4 million tons, while the average of an American plant was only 2.9 million tons (McCraw & O'Brien 1986: 86). There is little doubt that MITI's intervention in investment decisions greatly assisted Japan to exploit early-mover advantages to enable it to become by 1970 the world's most efficient steel producer.

To have made these massive investments, Japan's oligopolistic steel producers needed some assurance of market stability. The government provided that assurance. It permitted the formation of recession cartels and it protected the domestic market from imports. In fact, throughout the entire postwar period the import of steel products into Japan has been almost negligible. In the 1950s and early 1960s, when production costs in Japan were still high in comparison with other countries, the 'extremely high' levels of tariffs were an effective import barrier (Yamawaki 1988: 289; Yamazawa 1990: 176). So too was the system of rationing foreign exchange for imports. This system had the same effect as import licensing. Also acting as a non-tariff import barrier were the pressures exercised by the steel producers over their consumers and over the trading companies that distributed domestic and imported steel. These pressures effectively discouraged the distributors and the large customers (such as the automobile producers) from importing steel, even during the 1980s when steel producers in Korea, Taiwan and Brazil gained a cost advantage over the Japanese mills (Howell et al. 1988: 287).

The protected and rapidly growing home market enabled the industry to achieve impressive scale economies and to be well positioned to capture export markets when, by the late 1960s, capacity began to outstrip domestic demand. In that sense the Japanese steel industry is an illustration of how protection can serve as a form of export promotion. Exports were essential if firms were to maintain the high rates of capacity utilisation that were necessary if they were to cover the heavy fixed cost of their borrowed capital. Leaving aside the question of whether or not the Japanese producers actually engaged in predatory dumping, the industry's successful export drive caused serious dislocation to its competitors (Borrus 1983; Howell et al. 1988, ch. 7; Sato & Hodin 1982). Indeed, the excess capacity brought about by Japan's drive to expand its own steel capacity was in no small part directly responsible for the problems of severe excess capacity in the world's steel industry and for the bankruptcy of many steel companies in Europe and the US in the years since 1973. That no Japanese steel company has gone to the wall or has had to be bailed out by the government during these years of structural recession is further evidence of the long-term benefits the industry enjoyed from the government-sponsored low interest loans of earlier decades (Krugman 1987b: 287)

Did the targeting of steel help Japan? Krugman believes not. In his judgement, MITI's targeting of the steel industry encouraged Japan to invest in an activity with low returns, generated no visible side effects, acted as a drag on Japan's growth; and 'probably reduced Japanese national income' (Krugman 1987c: 289; Krugman & Obstfeld 1988: 270–1). As evidence, he points out that the depressed world industry after the mid-1970s meant that there were no rents for the Japanese industry to capture; likewise, the approximate technological parity between the US and Japan after 1960 meant there were few technological externalities to generate. This evidence is hardly conclusive. After all, there *were* years in the decade 1960–70 when the rates of profit earned by the steel industry exceeded the profit rate for all manufacturing (Imai 1980: 195). Furthermore, the fact that the Japanese industry *was* demonstrably superior to the US industry in process technology did provide scope for technological externalities (Eads & Nelson 1986: 258–59). The industries that used steel as an intermediate product also benefited from the pecuniary externalities. By nurturing more advanced industries (such as steel and automobiles) and assisting them (not least through import protection) to exploit dynamic scale economies, industrial policy helped Japan to close the technology gap with the US and Europe and to widen the range of Japan's competitive exports. In the process, the foreign propensity to import Japanese goods rose steeply while Japan's propensity to import declined (Itoh 1990; Itoh et al. 1988; Itoh et al. 1991). Japan reaped two benefits: a falling domestic price for a crucial intermediate input and, because of steel's relatively large share in export demand, a rise in national income relative to its trading partners.

Automobiles

Policies to assist the Japanese automobile industry during the high growth era illustrate the mechanism whereby import controls act as export promotion measures (Itoh et al. 1991, ch. 11). In 1951 the automobile industry was designated a strategic infant industry to be fostered by the government. (This represented a victory for MITI over the Bank of Japan, which had argued that Japan should base its foreign trade on comparative advantage, predicting that 'efforts to develop the automobile industry will be futile' (Mutoh 1988: 148). From then until the late 1960s, the industry benefited from a bundle of protectionist and promotional policies (Mutoh 1988; Ueno & Muto 1980). To encourage investment in the industry, the government supplied low interest loans through government-affiliated financial institutions, granted subsidies for technological development, provided substantial depreciation allowances for 'important' machinery, exempted necessary machinery and equipment from import tariffs, and, despite the severe foreign exchange restrictions, approved the import of foreign technology. Moreover, to secure efficient mass production, MITI arranged Japan Development Bank loans of 10 billion yen for the Nissan–Prince, Toyota–Hino and Toyota–Daihatsu mergers (Ueno & Muto 1980).

At the same time the government sheltered the industry from foreign competition. It did so by means of: protective tariffs, which until the early 1970s were much higher than those imposed by the United States and Europe (Winham & Kabashima 1982: 77); an excise tax, which discriminated against foreign cars; foreign exchange controls on imports; and severe restrictions on foreign direct investment. The latter two measures, reflecting the government's continuing shortage of foreign exchange and its fear of losing control over the direction of industrial development, established a system of prohibitions on all external transactions, including capital transactions. The measures 'kept foreign nationals at bay by insisting that technology licensing be decoupled from foreign equity' (Encarnation 1986: 122). Despite the attractions of a rapidly growing protected domestic market for cars in Japan, and despite the fact that the entry barriers facing domestic producers were relatively low (Ueno & Muto 1980: 165), the restrictions on foreign investment prevented any foreign manufacturer from gaining a beachhead in Japan. Foreign producers were forced to settle for licensing agreements and government-approved joint ventures. Even when joint ventures were permitted as a means of obtaining advanced technology from abroad, MITI still insisted that within five years 90 per cent of the licensed parts be produced in Japan (Winham & Kabashima 1982: 77).

Sheltered from foreign competition, the domestic industry—a competitive oligarchy characterised by product differentiation—was able to entrench itself in the home market. Unlike normal infant industry protection, however, the protection of the Japanese automobile industry was deliberately 'time-bound', for MITI and the industry realised that foreign pressures were certain to lead to the opening of the Japanese market. MITI made it clear that protection was a temporary measure, designed to give the local industry just enough time to prepare for liberalisation. The threat of future competition spurred the local manufacturers to accelerate their investment in ever-expanding productive capacity and to avoid excessive price competition. Faced with an expanding domestic demand, investment surged, permitting the manufacturers to exploit considerable static and dynamic scale economies and to engage in further capacity-expanding investment. Led by Toyota, the Japanese manufacturers embraced the techniques of lean and flexible manufacturing, enabling them dramatically to improve quality while at the same time producing a wider range of models on the same assembly line. The industry at this time enjoyed excess profits (Mutoh 1988: 324; Ueno & Muto 1980: 186). By the time passenger car imports were liberalised in 1964, the Japanese automobile industry was internationally competitive in terms of costs and quality. And by the time foreign investment restrictions were lifted in the 1970s, foreign producers found that the high capacity domestic firms had pre-empted the market. When domestic demand began to slacken in the early 1970s, the irreversible effects of these time-bound protective measures were strong enough to give the Japanese producers a decisive competitive advantage in foreign markets (Itoh et al. 1991, ch. 11). Exports jumped spectacularly from a mere 11 500 cars in 1961 to 1.3 million in 1971 (Ueno & Mutoh 1980: 161).

The benefits flowing from these measures were, moreover, not only the once-and-for-all gains derived from Japan's winning a dominant—and profitable—position in global automobile markets and thus securing a larger share of world profits. They were also the longer term benefits derived from the external economies flowing from the new techniques of flexible manufacturing and from possessing a world class industry producing a product with a high income elasticity of demand. The latter permitted Japanese cars in the 1970s to capture almost all the growth in the low-priced import market in the United States. In the words of one analyst, 'the American market, and to a lesser extent the West European market, became the engine that drove the growth of the Japanese auto industry' (Dunn 1989: 165). Thus, in terms of rents, externalities and growth efficiency, the promotional and protectionist policies of the 1950s and 1960s must also be judged a success. This is so, it should be stressed, despite the often-cited failure of MITI to rationalise the industry into two large groupings. The point to be made about that proposal is that the process of negotiated reciprocal consent between MITI and the private sector meant that MITI did not persevere with the plan once the industry's resistance was apparent. While it might have been a failure for MITI it does not represent a failure of MITI's overall strategy of protection and promotion of the industry. In fact, the protective 'greenhouse', by permitting firms to avoid price competition and to make excess profits, lowered entry barriers and made it possible for eleven manufacturers to co-exist. But business tie-ups reduced the number of effective competitors to six. And as they were dominated by the Toyota and Nissan groups of companies, MITI's policies actually resulted in a considerable degree of de facto rationalisation (Mutoh 1988: 323–24).

Colour television

Of Japan's achievements in the high growth period, one of the most dramatic was the rapid emergence of the colour television industry and its swift capture of export markets. In 1962 the Japanese television industry was producing barely 4000 sets a year. Four years later it was producing over half a million sets and exporting 267 000. In 1970 Japanese production overtook American. By 1975 Japan was making 11 million sets, two-thirds more than its US competitors, and of these sets fully 4.7 million were sold overseas (Peck & Wilson 1982: Table 1).

Some observers see the success of the Japanese colour television industry on world markets as owing little to government targeting. One even asserts that a firm like Sony owes 'nothing whatever to bureaucratic promotion, but everything to innovation, rivalry and low cost' (Kasper 1990). To depict the industry in that way, however, is to disregard the degree to which the surge of colour television exports was made possible by a combination of government policies: import tariffs and quotas, controls on direct foreign investment, lax enforcement of antitrust laws, tax incentives for exports, and a government coordinated and financed R&D program. As economist Kozo Yamamura, a leading American specialist in Japanese industrial policy, has argued, these unique policy incentives 'cannot be ignored' in any explanation of the Japanese producers' success in capturing a large slice of the American market (Yamamura 1986: 179).

The fledgling industry benefited greatly from import protection. Targeted by the *Provisional Measures Law Concerning the Promotion of the Electronic Industry* (1957), tariff rates ranged between 20 and 30 per cent until 1968. Despite liberalisation after that date, imports in 1980 amounted to no more than a minuscule 0.1 per cent of the domestic market (Yamamura 1986: 253). The industry also benefited from another form of effective market closure: restrictions on foreign direct investment (Peck & Wilson 1982: 209). Those restrictions, despite the undervalued yen and Japan's lower wage costs, prevented US firms from establishing subsidiaries in Japan or from acquiring the smaller Japanese producers and using their facilities for manufacturing portable sets. Throughout the 1950s and 1960s, Japanese producers were effectively insulated from foreign competition in the domestic market.

The closed market enabled the seven major Japanese manufacturers to reap the advantages of scale economies, especially for small sets. It also enabled them to cartelise the domestic market and to collude in setting high domestic prices. Resale price maintenance was facilitated by the *keiretsu* system of vertically integrated sales outlets (Yamamura 1986). In turn, the costs of establishing a *keiretsu* distribution system acted as a barrier not only for potential Japanese entrants to the industry but also for aspiring foreign entrants. In addition, potential foreign entrants faced legal obstacles. Unlike domestic firms they were prevented from underwriting instalment loans for consumer purchases, they were not permitted to make restrictive dealing arrangements with retailers, and if they wished to own 50 per cent of ten or more retail outlets they needed the approval of the government (Yamamura 1986: 246–7). The closed market compelled US manufacturers to license their technology to Japanese producers, a move that speedily closed the technology gap between the two industries. Special governmental grants and long-term low interest loans made it easier for the Japanese companies to purchase this foreign technology, as did the high domestic earnings.

The scale economies and the high profit base not only permitted the Japanese manufacturers to upgrade their production processes and incorporate new technological developments, they also 'provided the firms with the motivation and means to sell their products on world markets at prices below those commanded at home—possibly below the cost of production' (Yamamura 1986: 247). Using the extensive and detailed evidence presented in three antitrust cases against the industry heard by the Fair Trade Commission of Japan and in a number of US suits alleging antitrust and antidumping behaviour by Japanese television manufacturers, Yamamura & Vandenberg (1986: 265) argue that it is 'indisputable' that the Japanese manufacturers sold on the American market at prices far below those charged in Japan. They also show that this dumping occurred with the connivance of MITI, which sanctioned the industry's legal export cartel and its system of common minimum prices for exports. Yamamura and Vandenberg go further. They claim (1986: 259–63) that this collusive behaviour was consistent with the allegations by the American industry that the seven Japanese manufacturers were engaging in predatory behaviour. For example, the agreements not to compete with each other for the accounts of major US customers and to exchange detailed information about their US sales among themselves enabled them to increase their market shares at the expense of their American competitors. The massive surge in shipments of Japanese-made sets following the 1974–75 recession and the low-price tactics of the Japanese manufacturers severely harmed the American industry and decisively allowed the Japanese producers to gain a large share of the US market. The number of US producers fell from 27 in 1960 to five in 1980, employment plummeted and the US economy lost domestic value-added as the remaining manufacturers shifted their operations abroad. Even though America retaliated and negotiated an Orderly Marketing Agreement (OMA) that restricted Japanese imports, the technologically superior Japanese firms captured much of the rents created by the OMA by setting up their own subsidiaries in the United States (Peck & Wilson 1982: 209).

Government policy greatly assisted the Japanese industry in another way: through MITI's sponsorship in the 1960s of a research and development program to develop solid-state technology for colour television receivers. This R&D program generated external economies and facilitated the speedy commercial application of solid-state technology by domestic manufacturers, a breakthrough that Millstein (1983) describes as the crucial turning point in the technological superiority of the Japanese industry over the American. By 1971, two years before the leading US manufacturers were able to offer a line of solid-state products, 90 per cent of Japanese production was based on the new technology. This breakthrough gave the Japanese industry an invaluable edge over foreign competitors in developing the next generation of high technology consumer products based on television—the video cassette recorder (VCR). By the late 1980s, American firms had virtually abandoned the VCR market to the Japanese.

Semiconductors and computers

Over the last decade, semiconductor production has become the archetypical strategic industry. Countries covet a flourishing semiconductor industry not only because its technology spills over to other advanced industries but also because it is seen as essential for a nation's economic, technological and military strength. Characterised by steeply rising scale and learning economies, by extremely short product cycles, by highly expensive R&D, by pervasive external economies, and by enormous start-up costs, 'the semiconductor industry is about as far as one can get from the classical model of a perfect market' (Krugman 1983: 147). Little wonder the industry is regarded by many as the ideal target for strategic trade policy.

There is no doubting that the Japanese government singled out the semiconductor and computer industries for special assistance. In its vision of Japan's industrial structure in the 1980s, MITI stressed the need for a shift to a 'knowledge-intensive industrial structure' centred on advanced technology. Central to these visions was the development of the semiconductor and computer industries. Policies to promote these industries have included overt and tacit measures to protect domestic producers from import competition, demand-pull measures to benefit Japanese firms, a 'buy Japanese' policy of government procurement, subsidised loans for new investment, subsidies for R&D, officially sanctioned price and investment cartels, and government-sponsored collaborative R&D. The form of assistance, the subsequent market behaviour of the industry and the fact that the policies benefited domestic at the expense of foreign producers are consistent with the patterns to be expected on the basis of analyses offered by strategic technology theorists.

Although the most intensive fostering of the computer industry has occurred since 1976, the year when computer-related items were freed of quota and foreign investment restrictions, policies to promote the industry date back to the 1950s and 1960s. In those early years, when IBM held the basic patents for computer technology, protection was prominent in the armoury of measures to assist the infant mainframe computer industry. MITI, acting as gatekeeper to the Japanese market, bargained with IBM for its patents. In exchange for opening its patents to Japanese firms, IBM was allowed to set up a wholly owned subsidiary in Japan. MITI, however, was not prepared to give IBM free rein. Not only did MITI restrict the amount of profit that IBM could repatriate, it also delayed the start of IBM production in Japan by two years, prevented IBM importing parts for its locally manufactured computers, authorised which models IBM could produce in Japan, controlled the production run for each model, and required that a large proportion of IBM's production be exported (Anchordoguy 1990: 307). In essence, MITI prevented IBM from expanding beyond a certain share of the market. Texas Instruments was treated even more cavalierly. MITI refused to act on TI's application for patents on its semiconductor technology or its application to set up a subsidiary in Japan. MITI also stalled in allowing two other semiconductor firms—Fairchild and Motorola—to produce in Japan. Along with high tariffs and restrictive quotas, these delays permitted domestic producers to copy TI's semiconductor technology without having to pay for it and to produce for the local market without fear of foreign competition. Moreover, by dragging its feet on trade and capital liberalisation, the Japanese government provided domestic firms with 'the time to build up the economies of scale and technical expertise necessary to take away the market share from their foreign competitors' (Anchordoguy 1990: 309–10).

Even after tariff and quota barriers were lowered, domestic Japanese-owned computer and semiconductor producers continued to enjoy the protection afforded by officially sanctioned non-tariff barriers. These have included such stratagems as: requiring importers to meet convoluted certification procedures 'designed to exhaust all but the largest and most determined foreign firms wishing to sell in Japan' (Aho & Aronson 1985: 85); excluding foreign firms from the councils that determine product standards; reserving the most lucrative part of the market to Japanese firms—as Motorola found when it was told that the Tokyo–Nagoya area had been reserved for a Japanese manufacturer of cellular telephones (Anchordoguy 1990: 311); requiring foreign but not domestic firms to sign up customers before they could apply for licences (as Motorola also found); allowing sole-source tendering; and encouraging 'buy Japanese' procurement policies.

Government procurement has in fact been one of the demand-pull measures used to promote the domestic industries. Here Japan is no different from many other countries in encouraging local, prefectural and central government agencies as well as public schools and the national universities to buy their computers from domestically owned firms. As a source of demand, however, public procurement has been quite modest and accounts for less than 14 per cent of the value of all computers sold in Japan (Okimoto 1989: 99). For some Japanese companies, though, one public agency has exercised substantial demand-generating power. That agency has been Nippon Telegraph and Telephone (NTT) which, until its semi-privatisation in the mid-1980s, held the domestic telephone monopoly. Through its procurement and R&D budgets, NTT has been able to channel large amounts of funds to its 'family' of domestic telecommunication–semiconductor–computer suppliers—notably NEC, Fujitsu, Hitachi, and Oki. Between 1980 and 1986, its procurement budget alone amounted to $13.6 billion. This 'procurement bonanza' (Okimoto 1989: 100), most of which flowed to the four telecommunication companies in the NTT family, enabled the recipients to exploit economies of scale and learning economies and to plough capital back into R&D. Moreover, as Anchordoguy (1990: 315) suggests, the cross-subsidisation of the semiconductor and computer industries with NTT's telecom profits gave the integrated Japanese producers an unfair advantage over their foreign rivals.

Foreign firms have also found themselves at a distinct disadvantage in competing with domestic firms as a result of a computer-leasing scheme designed to stimulate demand for computers made by Japanese firms. In the 1960s, the dominant method of marketing computers in Japan was the rental system, pioneered by IBM. Because cost recovery took place over a long period, firms needed to borrow large amounts of capital to finance such rental schemes. In 1961, to ease themselves of this burden, the major domestic firms—Fujitsu, Hitachi, NEC, Toshiba, Mitsubishi and Oki—established, with MITI's backing, a joint leasing company. This quasi-private company—the Japan Electronic Computer Company (JECC)—has been the recipient of a massive flow of low interest JDB loans (as much as $2 billion between 1961 and 1981) to help it purchase computers from its member firms and lease them to the public at competitive rates. The intention of the scheme was predatory, to take market share from foreign firms, for IBM Japan (not to mention other US producers) could not rent their computers through JECC.

JECC has been described by America's best-informed student of Japanese computer policy as 'the most important single institution spurring the industry's development'; for without JECC, 'it is highly unlikely that a competitive Japanese computer mainframe industry would have ever developed' (Anchordoguy 1989: 60; Anchordoguy 1990: 318). JECC benefited the industry in three important ways. First, by purchasing computers from the manufacturers, JECC provided the member firms with up-front cash that could be immediately reinvested in plant, quality improvement, and R&D. This relieved the producers of having to obtain the large bank loans they would have needed to finance and administer their own rental schemes; loans that no company at that time with the possible exception of Hitachi would have been able to obtain from the banks. Being essentially an interest-free loan, the up-front payment constituted a 'vast, but relatively invisible' subsidy that Anchordoguy (1989: 69) estimates was worth a total of $22.5 million during the 1960s.

Second, the JECC arrangement made it possible for domestic computers to be leased at prices some 40 per cent below those that

IBM charged, even though the domestic producers' costs were higher than IBM's (Anchordoguy 1989: 64). By undercutting IBM, JECC created an artificial market for domestic machines. Demand surged. Within eighteen months of JECC's formation, the share of rented machines jumped from 4 per cent to 46 per cent. By 1965, it reached 78 per cent. More significantly, despite the technical superiority of IBM's machines, JECC enabled Japanese firms in 1965 to capture a majority share of the local market. Just four years earlier, foreign producers had held 82 per cent. There is little doubt that in a free market IBM would have continued to hold the lion's share of the market. The manipulated market under the JECC arrangement made sure that that did not occur.

Third, by only purchasing machines that users had requested, and by requiring manufacturers to buy back returned machines at book value, JECC ensured that the companies with the best machines got the best deal. Although JECC channelled a large flow of indirect subsidies to the industry and operated as a price cartel, its procedures forced its members to compete vigorously in terms of quality and technological development.

In the 1970s, no longer able to rely on market protection, MITI turned to another policy instrument to assist the computer and semiconductor industries: the use of joint government–private R&D projects. Like JECC, this instrument was predatory in intent. The goal of many of the projects was to match or surpass the technical capabilities of the leading foreign firms, notably IBM. For example, the 1966–1971 Super High Performance Electronic Computer (SHPEC) program was to catch up to IBM's System 360 series; the 1972–1976 3.5 Generation Project was in reaction to IBM's 370 series; the 1976–1979 Very Large Scale Integration (VLSI) Project targeted the expected use of VLSI memory circuits in IBM's Future Series. Because the projects were designed to foster countervailing power against a foreign oligopoly, foreign firms, notably IBM Japan, were excluded from the research consortia.

Observers generally credit the VLSI project with enabling Japan to close the technology gap with the US, and indeed to achieve technological superiority in areas such as non-silicon products, new materials, and high density memory devices. They doubt that Japanese firms would have been able, without the catalytic effect of the VLSI project, to commercialise the 64K dynamic random access memory (DRAM) chip as early as they did or to capture 70 per cent of the world market for 64K chips by 1981–82. Because the projects had the effect of correcting particular market failures, various economists have judged the projects to have been economically worthwhile

(Fransman 1990; Goto & Wakasugi 1988; Shinjo 1988). For example, by providing incentives to encourage the leading semiconductor firms to participate in joint research, the projects organised by MITI and by NTT were able to overcome the collective action problem which often deterred firms from collaborating on R&D. These projects were also able to correct the market failures (ones associated with externalities, public goods, declining costs, and uncertainty) that threatened to cause underinvestment in basic research. By bringing together technical staff from the participating firms, the joint research projects also checked the tendency of the lifetime employment system, with its low labour mobility, to hinder the diffusion of technical knowledge among firms. Among additional economic benefits to flow from the VLSI project, Fransman singles out the synergistic effects of the improved flow of information among the participating firms and the economies of joint R&D (from pooling technical information, sharing costly non-divisible equipment, and avoiding wasteful duplication in research). To counter the argument that the market could have been relied upon to produce these benefits, he points out that not only did MITI have to force the firms to participate in the joint projects but that in the whole postwar period there were only two cases of spontaneous research cooperation among Japan's major electronic firms not prompted or assisted by the government or a government agency such as NTT (Fransman 1990: 279) .

In the 1980s, MITI based a further series of joint R&D programs on the VLSI model. These projects targeted new technologies such as optoelectronics, supercomputers, and future electronic devices. Having reached the technological frontier in many areas of computers and semiconductors, the problem facing Japanese companies at that stage was the uncertainty and risk inherent in 'over the horizon' R&D. MITI helped reduce these uncertainties. It did so by socialising the risk, by reducing the transaction costs of collaborative research, and by selecting in close cooperation with industry the technologies for development. MITI's funds not only acted as a magnet attracting additional corporate investment into the selected areas, but were also important in their own right. Around 20 per cent of the research resources spent by certain firms on R&D projects with a time horizon of ten years or more came from MITI (Fransman 1990: 288).

A crucially important feature of all these projects has been their focus on developing generic technologies—those with broad application to products and processes—and seeing that these were diffused among competitive firms. The government reduced the cost of the riskiest and most uncertain aspect of the R&D process and it gave the competing firms a common technological base. But it left the commercialisation of the technological advances to the firms. In this way MITI shrewdly avoided the pitfalls of attempting to pick winning products. It also ensured that competition would have to centre on improving quality and lowering costs. Further, by providing the institutional context in which semiconductor producers could work with the producers of semiconductor fabrication equipment, the VLSI project helped to generate the technical synergies to be derived from 'learning by using' (Stowsky 1989).

By establishing itself at the forefront of semiconductor process technology and by massively investing in new equipment to exploit scale and learning economies, the Japanese industry emerged in the 1980s as the global leader in quality and price. Facing significant dynamic learning economies (Yamawaki 1992), the semiconductor producers followed a predictable and rational path of below-cost sales, thereby undercutting their American competitors, a move which prompted charges of predatory dumping (Dick 1991). Whether or not this practice of forward-pricing was intentionally predatory, it did have a predatory effect. In 1980–81, having commercialised the technology developed in the VLSI project, Japanese firms captured a dominant share of the world market for the 64K DRAM. By the end of 1986, Japanese firms held 90 per cent of the market for the 256K DRAM and were to dominate future generations of this product. The Japanese producers in 1986 overtook their US competitors in the production of semiconductors. In 1979 the US industry had held 57 per cent of the world market; by 1990 its share had fallen to 37 per cent (Flamm 1991: 26). The decline in American competitiveness has been even more dramatic in semiconductor tooling, where the US share fell from 85 per cent of the world market in 1978 to 50 per cent in 1987 (Borrus 1988b: 68).

Some strategic trade theorists have been reluctant to concede that MITI's policies to promote the computer and semiconductor industries benefited Japan. Their evaluation is based on two criteria: (a) did the targeted industries earn excess returns? and (b) did the industries generate technological externalities sufficient to justify the costs of the promotional policies? To take one prominent example, Krugman (Krugman 1987c: 293; Krugman & Obstfeld 1988: 272–4), admittedly writing in the mid-1980s, claimed that it was too early to say that MITI's policies had been successful: on the one hand, price cutting had so far prevented the Japanese semiconductor firms from earning above normal rates of return on their investments; on the other hand, the putative external economies flowing from the knowledge generated by R&D in the semiconductor industry had 'yet to be seen'. Along with a number of other contributors to the new trade theory, Krugman was sceptical that these technological externalities, by definition unpriced, could be measured. And even if they could, and were shown to be large, he was doubtful if they were of the sort that could be appropriated and largely retained within Japan's borders (Krugman 1984b: 112).

Evaluations of this sort have been challenged. On the question of excess returns the critics question the claim advanced by Krugman and others (e.g. Pugel 1987: 214) that industry returns were low, on the grounds that the claim is not based on a systematic analysis of profits adjusted for the entire business cycle, does not take into account profit linkages over a sequence of generations of a product, and wrongly assumes that strategic trade theory requires that profits be present for the whole product cycle (Lawrence 1984; Raubitschek 1987). The claim is also questioned for being based on a standard accounting rate of return that does not adequately capture the concept of rents. Empirical studies, in fact, have shown that Japanese semiconductor firms have typically recovered their costs over the course of more than one product cycle (Dick, 1991). Moreover, by the late 1980s, largely as an unintended consequence of the US–Japan Semiconductor Agreement, the Japanese semiconductor firms had actually turned themselves into what *The Economist* in 1990 dubbed 'a rent-collecting chip-making cartel'.

Krugman's scepticism about externalities has been challenged from three directions. First, by studies that demonstrate the presence of social rates of return in high technology industries. For example, economic modelling by Flamm (1987: 223–39) shows that the social return on investment in computer technology is 'quite high' even under fairly conservative assumptions.

Second, by observers who deny that new technological knowledge is quickly and easily transmitted abroad by such means as 'reverse engineering'. They argue that crucial advances in the design and production of semiconductor fabrication equipment diffuse more readily in the country of origin. This is because they are transmitted through the close ties between engineers in the fabrication equipment producers and those in the user firms. This tacit technology is embodied in experience, not simply in the products themselves (Borrus, Tyson & Zysman 1986). These observers also point out that the *keiretsu* links between upstream and downstream producers in Japan serve to hinder the international diffusion of technological spillovers (Borrus 1988b), as does the exclusive membership of MITI's joint research projects. To the degree that leading industries, such as semiconductors, yield opportunities for innovation in the downstream industries, and if information about such opportunities circulates more effectively within rather than across national boundaries, these industries may be thought of as 'strategic' for the nation, and thereby deserving of special protection or promotion (Nelson 1984: 3).

Third, by scholars in the strategic technology school who emphasise a quite different notion of spillovers (Dosi, Tyson & Zysman 1989; Tyson 1988). The issue as they see it goes beyond the 'false formalism' (Tyson 1988: 115) of debating whether technological externalities can be measured. The issue also goes beyond the undoubted presence of linkage externalities (i.e. the spillover effect resulting from increasing returns in the semiconductor industry on the costs of higher value-added downstream industries). In their eyes, the issue concerns the role of the semiconductor as a 'strategic transformative' technology, one that is radically transforming the products, production processes and product quality in a wide range of industrial sectors, contributing profoundly to productivity growth, and directly affecting the international competitiveness of national producers that exploit its transformative potential. MITI's wisdom in promoting the semiconductor and other advanced technology industries lies in its recognition both of the need to target industries on the basis of their growth and technological potential and of the need on occasion to trade off allocative efficiency for technological efficiency. For example, woven through the text of MITI's vision for the 1980s is a clear understanding of the major long-term 'ripple effects' of 'epochal technological innovation', of the bargaining leverage that possession of this technology would give Japan, and of the need for the government to promote these technologies when their development is 'urgently needed by the economy and society' and when it requires massive investment, R&D coordination among firms, and a long gestation period before results can be marketed (MITI 1980: 136, 145, 148). From the 'strategic technology' perspective, MITI's achievement lies in the 'long-term beneficial effects (of its policies) on the competitive position of Japanese producers in a variety of critical industrial sectors on world markets' (Dosi, Tyson & Zysman 1989: 32). The strategic implications of these effects are being felt by its competitors today. As the US semiconductor industry has learned to its cost: 'a competitive advantage, once lost, is exceedingly difficult to regain' (Flamm 1985).

Republic of Korea

It has become a generally accepted axiom among neoclassical economists that an export-oriented strategy of industrialisation is superior to an inward-looking one based on import substitution (Bhagwati 1990; Greenaway & Reed 1990 survey the literature). Because it exposes exporters to world prices for their inputs and their output, an outward-oriented strategy is said to ensure that resources are allocated according to a country's comparative advantage. These economists frequently depict Korea as a pre-eminent exemplar of export-oriented industrialisation (see Balassa & Associates 1982; Krueger 1978; Little 1981). By maintaining the exchange rate near the free trade level, exempting intermediate inputs and export sales from indirect taxes and granting exporters unrestricted and tariff-free access to imported inputs, the Korean government has provided a virtual free trade regime for exporters. In this way it has assured exporters in internationally competitive industries that production for export would be no less profitable than production for sale on the domestic market. In other words, it has 'offered little incentive for industries producing exportables to keep their output at home' (World Bank 1987, vol. 1: 35).

These export-promoting incentives allowed Korea to exploit its comparative advantage. As shown by Westphal and Kim (1982) and Nam (1981; 1982), 'effective incentive rates' were neutral in their effect for well-established export industries in the sense that they did not distort prices relative to what those prices would have been under a free trade regime. Moreover, because the effective incentive rates on exports for individual industries were narrowly dispersed around the overall average, the policies did not discriminate between export industries. As a result, Korea's pattern of exports at that time reflected its comparative advantage in labour-intensive products such as textile fabrics, wigs, plywood, and footwear. As Westphal puts it, Korea's export-oriented strategy provided 'an almost classic case of an economy following its comparative advantage and reaping the gains predicted by conventional economic theory' (Westphal 1978: 375).

However, to depict Korea's industrialisation strategy as essentially one of export-promotion based on non-selective policies of 'unshackling exports' is to tell but half the story. It fails to acknowledge three important aspects of the Korean development strategy. First, that the Korean government has since the early 1960s actually pursued *two* proximate industrial objectives: to encourage exports from industries where Korea has an established or readily attainable comparative advantage *and* to promote infant industries (Westphal 1990). While the first objective has utilised measures without any discernible trade or industry bias, the second has relied on protection and other selective measures to promote industry (Pack & Westphal 1986; Westphal 1982; Westphal 1990). Second, that the two objectives were interlinked. Infant industries were forced to export. In that sense, the Korean government used import substitution as a means of export promotion. Third, that among the export incentives offered to established export industries were many genuine subsidies. These subsidies included: reductions of direct taxes earned in export activities; accelerated depreciation allowances on capital used in export production; generous wastage allowances on duty-free imports of raw materials; preferential rates on overhead inputs such as electricity and railway transportation; and, most importantly of all, preferential access to short- and long-term credit for exporters. As Nam (1990) writes, Korea pursued its outward-oriented strategy by following the export subsidy not the free-trade route. According to Amsden (1990), subsidies were as crucial in the 1960s to the cotton textiles industry in competing with Japan, despite Korea's low wages, as they later were for the steel and shipbuilding industries.

There is, in sum, little in the Korean experience to lend support to the neo-liberal interpretation that Korea's industrialisation strategy was built around free trade and an aversion to selective intervention. Instead, analyses of Korea's extensive and coordinated use of subsidies to promote infant industries and to encourage exports show that Korean policy has been informed by a 'strategic' orientation consistent with interventionist rationales advanced by strategic technology and strategic trade theorists. True, the Korean evidence does not directly indicate that Korea deliberately used trade and industrial policies as a strategic move to deter foreign competitors, and thereby shift profits to Korea. The evidence does, however, point to those policies having a deterrent effect on foreign shipbuilders, automobile manufacturers, and semiconductor producers. For example, backed by a credible government commitment to develop the semiconductor industry, Korean firms were able to present a convincing challenge to Japanese dominance in memory chips. Indeed, price cutting by Samsung on 1M DRAMs forced Japanese companies out of the market (Tyson 1992: 126). In steel, shipbuilding and automobiles, the Korean firms chose to add to surplus capacity rather than to provide markets for Western and Japanese producers. The evidence also points to the Korean government's having deliberately employed trade and industrial policies to generate technological external economies, to establish internationally competitive export industries, and to encourage those industries to exploit static and dynamic scale economies. In addition, the export success and profitability of the automobile and semiconductor industries suggests that Korea's policies of selective assistance resulted in profit shifting.

In promoting its targeted infant industries, the Korean government has aggressively used a range of selective policy instruments. These have included import restrictions, tax breaks, controls on direct foreign investment, and the preferential allocation of credit. By means of these instruments Korean policy was designed to shift Korea's comparative advantage from labour-intensive to capital- and skill-intensive production, to foster the rapid acquisition of domestic technological mastery, to permit the exploitation of scale economies, and to compel infant industries to begin exporting early.

Protection was the main promotional incentive for designated infant industries. Under the First Five Year Economic Plan (1962–1966), these industries included cement, fertilisers, synthetic fibres, and oil refining. They were followed in the late 1960s by steel and petrochemicals. In the 1970s, under the plan to promote self-sufficiency in the 'heavy and chemical' industries (HCI) and to upgrade Korea's export potential in capital and intermediate goods, import protection was extended to nonferrous metals, shipbuilding, heavy machinery, transport equipment, motor vehicles and, although they were neither heavy nor chemical, consumer durables and electronics. Although the HCI drive was abandoned in 1979, the automobile and electronics industries continued to be protected. Import restrictions were still used as late as 1988 to protect high-tech products such as computers, electronic amplifiers, cameras, VCRs, integrated circuits, teleprinters, and colour TVs (World Bank 1987, vol. 1, ch. 3).

Protection generally took the form of quotas that set ceilings on imports. These quantitative restrictions were designed to give the targeted industries an acceptable level of domestic sales and a satisfactory rate of return on investment. The quotas applied to a sizeable proportion of imports. In 1978, as a result of the HCI drive, the proportion of restricted items was 40 per cent of all import items (Nam 1982, 540:17) For particular industries being promoted, the share of restricted items was often very high. For example, the proportion of iron and steel products facing restrictions jumped from 28 per cent in 1967 to 75 per cent in 1978 (World Bank 1987: 59). The quotas frequently gave absolute protection to a newly targeted industry and were removed only when the industry had become internationally competitive. Protection from imports also took the form of tariffs, strict local content requirements, 'buy-Korean' government procurement, health and safety inspection requirements, and applying a 'law of similars', under which an import licence is issued only if an importer can show that the specific item cannot be obtained domestically.

In addition to protection, the government also promoted the development of strategic domestic industries by restricting and regulating the inflow of foreign direct investment. Industries were encouraged to use licensed technology and foreign capital loans rather than foreign direct investment (Haggard & Chen 1987; Koo & Bark

1992; Luedde-Neurath 1984; Mardon 1990). In this way the government effectively 'decoupled' foreign technology and capital from foreign control (Mardon 1990). Foreign direct investment was allowed only if it met the government's development objectives. It was permitted under two conditions: if it produced exports; or if it provided necessary technology for specially targeted import substitution industries, where that technology could not be obtained locally or under licence. As a result, most of the foreign direct investment in manufacturing has flowed into sectors that state planners designated as target sectors. To increase transfers of technological and managerial skills to domestic firms and to assist domestic capital accumulation, the government normally insisted that the foreign investment take the form of a joint venture with Korean firms. Again the exceptions reflected Korea's national priorities: wholly owned foreign enterprises were permitted where production was to be exclusively for export (the rationale being that Korea would benefit from the foreign investor's knowledge of, and access to, foreign markets) or where larger shares of foreign investment were needed to attract more sophisticated technology. The outcome has been a low level of foreign investment in the Korean economy and an unusually low proportion of wholly foreign-owned firms (Mardon 1990: 128, 133).

Of all the instruments used for infant industry promotion, the selective allocation of credit has had the most impact on Korea's industrial structure. Through its control of the entire credit system (the banks were not privatised until the 1980s), the government has been able to direct the commercial banks to accord designated 'strategic' industries preferential access to 'policy loans' at substantially subsidised rates. During the HCI program, for example, the cost of capital to the HCI sector was as much as 20 to 30 per cent below that for light industry (World Bank 1987, vol. 2, ch. 5). In this way, and because of the highly leveraged nature of Korean industry, the government has been able to determine not only the level and rate of industrial investment but also its direction. In the 1970s, the discretionary allocation of subsidised loans to targeted sectors saw investment flowing into the export sector, the chemical and heavy industries, and the large conglomerates (known in Korea as *chaebol*). The government also used the credit system to increase Korean ownership and control in key sectors. Targeted infant industries received subsidised loans to purchase foreign technology and to repurchase equity held by foreign firms. By favouring the *chaebol*, the government's planners hoped to set up a small set of very large, domestically owned and controlled, diversified enterprises amenable to governmental direction and capable of surmounting the high entry barriers in the HCI sectors and of maximising scale economies in production, R&D, and exporting. For example, the *chaebol* were given preferential access to concessionary credit to establish general trading companies modelled on Japan's *sogo shosha* in order to achieve scale economies in exploring new markets and in establishing overseas sales networks (Rhee, Ross-Larson & Pursell 1984: 65).

In fact, what is quite distinctive about these various measures to protect and promote domestic industries is that they were crafted in such a way as to be export promoting. Exports were encouraged by allowing exporters to practise discriminatory pricing on the home market; and exports were induced by allocating preferential credit on the basis of export performance and by requiring both export industries and infant industries to meet export targets. Evidence indicates that the government has sanctioned non-competitive market structures in order to elicit export-related sales from infant industries. By limiting the entry of firms into an industry and providing them with a protected home market, the government enabled the favoured firms to subsidise their export sales by charging higher prices in the protected domestic market. In this way, they could maximise their profits by selling a proportion of their output overseas up to the point where the marginal cost of production equals the marginal revenue from these sales (Westphal 1982: 271). The result, as Westphal writes, is that 'infant industry' has been a less apt characterisation in Korea than 'infant exporter' (Westphal 1978: 375). Moreover, by making access to concessional credit and to discretionary permits (e.g. to work with foreign firms or to import technology) conditional on export achievements, the government required potential recipients to be exporters. And its export targets virtually compelled export industries and infant industries alike to keep expanding their exports (Rhee, Ross-Larson & Pursell 1984). As Amsden (1990: 74) has written: 'Big firms and small firms, young firms and old firms, chaebol and nonchaebol had to export. Investment and trade policies became intimately bound'.

It was this insistence on making exports 'a compulsion rather than a choice' (Amsden 1990: 69), that enabled the Korean planners to elicit from the recipients of governmental subsidies progressive increases in production volumes, in quality, and in productivity. The insistence that infant industries compete in international markets also helped the planners to achieve the elusive balance between economies of scale, often requiring monopolised or oligopolistic market structures, and competition (Green 1992: 420–1; Mody 1989: 307). Targeted industries soon became leading export industries. This group includes a number that were direct beneficiaries of the HCI drive, such as steel, shipbuilding, electronics, and automobiles. (For a positive reassessment of the HCI drive see World Bank (1992).

Even the export success of the semiconductor industry, often said to have been the result of private initiatives, stems in part from the policy of the HCI years to promote the large diversified conglomerates: by the mid-80s they had attained the market power to internally cross-subsidise the development of the semiconductor industry, to surmount the high entry barriers, and to provide the marketing know-how (Mody 1989; Mody 1990). It also benefited from the rapidly growing domestic demand for memory chips created by the earlier HCI policies (Yoon 1992) as well as from more direct assistance and intervention, such as a public research institute that planned and coordinated semiconductor R&D, fiscal investment incentives, large amounts of concessional credit, government-initiated integration of upstream and downstream segments of the market to maximise technological spillovers, and the assigning of the three private sector champions (Samsung, Goldstar and Daewoo) to profitable segments of the protected telecommunications market (Wade 1990: 312–18). The profitability of the semiconductor champions at the end of the 1980s, and the marked inroads they were making in world markets, were at least as much a result of governmental promotion as they were of the foresight and patience of the *chaebol*.

The Korean experience shows that import substitution policies need not be incompatible with an export-oriented development strategy. It shows, in fact, that protection can be used in combination with subsidies to foster the creation of internationally competitive industries and to give those industries a profitable domestic platform from which to launch an export push. Recent research on Korean industrialisation suggests that the Korean strategy was successful in attaining international competitiveness for two reasons (Amsden 1990; Biggs & Levy 1990; Pack & Westphal 1986; Westphal 1982; Westphal 1990; World Bank 1992). First, it assisted firms to realise static and dynamic internal economies of scale. Second, by helping firms to move down their learning curves and by correcting imperfections in capital markets and international technology markets, it generated external economies. These are precisely the benefits that writers in the strategic technology school believe can be realised by appropriate state action.

By providing firms with a protected home market and by using subsidies to socialise the risk of large scale investments, the Korean government enabled firms to achieve scale and learning economies based on large and expanding production volumes. This in turn allowed firms to exploit their falling cost curves to capture export markets from foreign competitors. It also made it possible for the government, once export markets had been staked out, to wind back its subsidies and the level of protection. Korea in this respect followed the Japanese model: it supported at any one time only a 'narrow moving band' of infant industries, providing protection until a targeted industry was internationally competitive, then moving on to the next target. The compulsion to export, in its turn, enabled further economies of scale to be exploited, thus further reducing unit costs of production and leading to lower domestic prices than would occur in its absence (Pack & Westphal 1986: 273).

A number of economists who have been associated with the World Bank's project work in Korea have emphasised the second way in which infant industry protection and subsidies can yield net benefits to the economy: through accelerating the acquisition of technological mastery (Amsden 1990; Dahlman, Ross-Larson & Westphal 1987; Dahlman & Westphal 1982; Rhee & Westphal 1977; Westphal 1982; Westphal, Kim & Dahlman 1985; Westphal et al. 1984a; Westphal, Rhee & Pursell 1981; World Bank 1992). In their view, late industrialisation is a process of borrowing foreign technology and optimising its assimilation. But this process of 'industrialisation through learning' (Amsden 1990) is hindered by market failures. The imperfect appropriability of investments in technological acquisition leads firms to underinvest in technological effort. The less than perfect tradeability of technology hinders the acquisition of technological capability. It also generates external economies for local firms who are able to benefit from domestic learning. They benefit in the form of lower prices, more locally appropriate inputs, and a cost-free diffusion of the new techniques. The failure of interlinked industries to realise that the welfare of one depends on the investments of the other causes underinvestment and a consequent failure to generate mutually beneficial pecuniary externalities. Similarly, technological externalities, arising from complementary learning sequences in firms linked to each other in the production chain, result in their failure to coordinate their investment in training and technology. The imperfect knowledge that foreign investors have about local conditions leads them to underinvest in local learning or technology transfer. The Korean government, it is suggested, has overcome many of these failures by its policies of promoting and coordinating large investments in related industries, of subsidising the import of technology, and of requiring foreign investors in joint ventures to adhere to strict conditions concerning technological transfer to ensure indigenous learning. (Pack & Westphal 1986; World Bank 1992). These policies have all contributed to Korea's 'capability acquisition' (World Bank 1992) and its ability to capture dynamic technical externalities, as has the policy of requiring infant industries to begin exporting sooner rather than later. Evidence points to exporting as a particularly important mechanism of acquiring technological mastery (Dahlman, Ross-Larson & Westphal 1987; Pack & Westphal 1986; Rhee, Ross-Larson & Pursell 1984; Westphal 1982; Westphal, Kim & Dahlman 1985; Westphal et al. 1984a; Westphal et al. 1984b). In summary, Korea's trade and industrial policies, as Biggs and Levy (1990) write, 'emerge as a coherent package of non-neoclassical policy instruments to force the pace of organisational learning'.

Taiwan

Taiwan's remarkable economic growth, like that of Korea, is frequently cited as demonstrating the benefits of an export-oriented industrialisation strategy. And, as in the case of Korea, the key elements in the strategy are said to be the virtual free trade regime enjoyed by exporters and the small role played by the government in the domestic economy: by 'getting the prices right', the Taiwanese authorities provided the crucial conditions for rapid export expansion which in turn generated the high rate of real output growth. As in the Korean case, however, this interpretation of Taiwan's economic development is incomplete. It overlooks the fact that while exporters (but not import-competing industries) have benefited from a near free trade regime, they have also benefited from substantial governmental subsidies: concessional credit for export production, short-term export credit, preferential tax treatment for export sales, and governmental help in overseas marketing. It also overlooks the fact that Taiwan's export-oriented policies have co-existed with (indeed depended on) import substitution policies for a different set of industries. As Wade (1990) demonstrates in his impressively detailed account of Taiwan's industrialisation, the Taiwanese government has guided and steered the economy to a far greater degree than is consistent with neoclassical theory. It is our argument that much of Wade's evidence of government steerage in Taiwan fits comfortably with the interventionist policy implications of strategic trade and strategic technology theory.

Both before and after the adoption of an export-oriented industrialisation strategy in 1958–1962, Taiwanese planners consciously took the initiative in steering resources into selected industries so as to shape the investment and production patterns in the economy. The aim was to promote the development of Taiwan's production and technological capacity in more skill- and capital-intensive industries and 'thus to permit a steadily more differentiated range of export products' (Wade 1988: 45). Various measures have been used to effect this steerage. They have included trade controls (including controls on direct foreign investment), fiscal incentives for the production of specified products, selective credit allocation, state-sponsored R&D organisations, and the extensive use of public corporations to create new capacities in upstream activities where entry barriers were high (notably in steel, shipbuilding, petroleum and petrochemicals, synthetic fibres, heavy machinery, and nuclear power). More recently, publicly owned enterprises have been used to acquire and commercialise new technology in the information industry. Among the industries whose establishment and development the government has promoted in its successive four-year economic plans have been: in the 1960s, electrical and electronic appliances, the heavy and chemical industries, and synthetic fibres; in the 1970s, steel, petrochemicals, electrical machinery, electronics, precision machine tools, and computer terminals and peripherals; and, in the 1980s, automobiles, semiconductors, and bio-technology.

In selecting these industries (and in some cases specific products), Taiwan's planners employed a number of criteria: whether an industry was considered to require large long-term investments beyond the capabilities of the capital market; to have a high potential for technological change; to be of military significance; or to be of special importance for the economy's future growth, 'either to reduce the economy's vulnerability to foreign (especially Japanese) suppliers, or to generate a higher value-added, more income elastic, more closely interlinked set of productive activities' (Wade 1988; Wade 1990: 180, 334–35). These criteria were supplemented by a close study of Japan's industrial trajectory and of changing patterns of demand in world markets. Apart from the military criterion, the planners were very much guided by notions of Keynesian and Schumpeterian efficiency.

Trade policy, as Wade shows, has been used as an important instrument of governmental steerage to bring about secondary import substitution and to build Taiwan's technological capacity. Quantitative restrictions have been more important in this respect than tariffs. Although imports have been publicly classified as 'prohibited', 'controlled' and 'permissible', the classification conceals the degree to which items in the permissible category are subject to further administrative controls. These take the form of a de facto 'law of similars' as well as origin and agency restrictions; that is, certain permissible items cannot be imported if similar items (in terms of price, quality and delivery) are available locally; if they come from particular countries, which happen to be Taiwan's main competitors; or if they are not imported by end users. The law of similars has covered a number of capital-intensive basic products such as steel, petrochemicals, chemicals, and certain items of heavy machinery. Even exporters have not been able freely to import some very important intermediate products and capital goods (Wade 1988: 142). Nevertheless, exporters have been able to buy most inputs at close to world market prices because the government has 'used world market prices as a guide to what the prices of domestic items should be, using the threat of imports as a means to make sure their guidance is followed' (ibid: 141). The authorities relied more on this threat than on forcing infant industries to export as the preferred means of overcoming the lethargy-inducing effects of protection (ibid: 155).

Despite the ample evidence showing that the Taiwan government has actively employed trade and industrial policies to shape the pattern of investment and production in the economy, the evidence does not point to the government's having deliberately used these policies in a game-theoretic way to shift profits away from foreign rivals. One reason for this may lie in Taiwan's industrial structure. Taiwan's economy is not dominated by huge diversified conglomerates as is Korea's. Nor did the Taiwanese authorities attempt to create such conglomerates. Indeed, the mainlander-dominated government was concerned to prevent the emergence of large corporations in the predominantly islander business community as these may have posed a threat to its power. Aside from the large, often publicly owned corporations in upstream industries, highly competitive small-sized firms have been a pervasive feature of Taiwan's manufacturing export industries. Government subsidies to these small firms may not have been nearly as effective as subsidies to large oligopolistic firms in making a credible commitment that would persuade foreign rivals to produce less or to withdraw from the market. On the other hand, subsidies may well have had a deterrent effect in certain product markets characterised by monopolistic competition—differentiated, non-standardised product markets with low or negligible entry barriers, the very sorts of markets in which Taiwan's export firms were pursuing a strategy of niche-marketing (Biggs & Levy 1990; Levy 1988). Available evidence does not, however, permit a definitive answer.

The relatively small size of the domestic market in Taiwan, combined with the proliferation of small firms in the export sector, has similarly tempered the government's ability to employ the second main type of strategic trade policy—protecting domestic firms from imports to enable them to reduce unit costs by exploiting sizeable static and dynamic economies of scale, and thereby to capture export markets from their foreign rivals. Likewise, the relatively small size of the home market has no doubt reduced the scope for local firms to practise discriminatory pricing in the protected domestic market in order to subsidise their export sales. But this is not to say that policies to help firms realise economies of scale have been inconsequential. The protection and subsidies given to producers of intermediate products and capital goods, and the restrictions on entry into some of those industries (such as synthetic fibres and petrochemical derivatives), have allowed many of these upstream manufacturers to achieve considerable economies of scale, which in turn have flowed on to domestic users in the form of lower prices—a valuable pecuniary externality for exporters. In addition, given the presence of monopolistic competition in many of Taiwan's product markets, subsidies may have permitted exporters to expand exports and to move down their average cost curves, in turn bringing about more competitive export prices as well as lower prices for domestic consumers (Venables 1984; Venables & Smith 1986 presents a theoretical discussion of this possibility).

More important than the 'strategic trade' effects of Taiwan's selective industrial and trade policies have been their effect in generating external economies and enabling them to be captured by the domestic economy. As Wade (1990: 353–54) and Biggs and Levy (1990) have argued, many of these policies can be interpreted as efforts by the Taiwanese authorities to ensure that market conditions—capital constraints on large, long-term investments, information asymmetries, coordination failures among firms—did not obstruct the realisation of external economies. Some of the externalities, as mentioned above, have been pecuniary—where one firm's increasing returns to scale are enjoyed by other firms and industries in the form of lower prices or higher quality inputs. Others, though, have been technological externalities—unpriced spillovers from one firm's activities which benefit the production function of other firms and industries.

Taiwan has maintained a dualistic trade regime: government policies have favoured export sale by the mainly small- and medium-sized enterprises in the export sector but favoured domestic sale by firms in the import-competing sector. By initiating investment in and directing capital towards consecutive sets of basic upstream industries, the government's planners provided new profit opportunities intended 'to spark an endogenous downstream expansion of private firms as a result of its initiatives' (Biggs & Levy 1990: 383). These initiatives helped generate sequential externalities that contributed to the economy's productivity and growth over and above the profits earned by the targeted upstream industries. These investment initiatives also generated simultaneous externalities—benefits that are contingent on the complementary and simultaneous decisions of interdependent actors, and which are often lost if left to the uncoordinated investment decisions of private agents—by ensuring the concurrent expansion of related industries.

Other policies had the clear objective of promoting Taiwan's technological capability. Among trade policies, the use of the law of similars fostered technological acquisition through 'learning by using': by preventing manufacturers importing particular intermediate products, these measures brought downstream users and local suppliers together and encouraged the latter to upgrade their production processes so that their products would meet the specifications demanded by the users. 'Repeated across many products, this mechanism can nudge the production structure of the country upwards' (Wade 1990: 360). The government helped private firms search for the most appropriate foreign technology and negotiated licensing agreements on their behalf. Government controls on direct foreign investment were used to set conditions for technology transfer. And the government set up state-owned technology research institutes to acquire and adopt foreign technology. Government-supported R&D—necessary to overcome the market failures associated with information spillovers, with the capital constraints and coordination difficulties faced by Taiwan's proliferation of small-sized firms, and with high entry barriers resulting from short product cycles and steep learning curves in high technology sectors—has been a particularly important measure in promoting 'strategic technologies' in Taiwan. Studies of government-initiated R&D in the machine tools industry (Fransman 1986) and in the informatics industries—computers, semiconductors, telecommunications (Mody 1989; Mody 1990; Schive 1990: Wade 1990: 106–8)—indicate the crucial role played by the state in assisting these strategic industries rapidly to master, improve, disseminate and commercialise the new technologies and to achieve international competitiveness. As Biggs and Levy (1990: 369) observe, 'externality-creating investments promoted (and sometimes undertaken directly) by government appear to have been unusually important in Taiwan's successful industrialisation'.

GOVERNMENT FAILURE IN NORTHEAST ASIA

Most economists who have acknowledged that there may be a case in theory for strategic trade policy have denied that it will succeed in practice. The reason, stated succinctly by Paul Krugman (1987b: 143) in a phrase often cited in this debate, is that one should adopt 'free trade as a rule of thumb in a world where politics are as imperfect as its markets'. Commentators who fear that intervention will lead to government failure point to the probability that governments will have insufficient information to make decisions on efficiency that would otherwise be dictated by millions of consumers in the marketplace (Krugman 1987b: 139; Lawrence 1984: 105; Spencer & Brander 1983: 711).

They also bring to bear on their analysis the formidable armoury of the theories of collective goods and rational choice. As government intervention will inevitably change income distribution, the danger, according to Krugman (1987b: 141) is that 'the politics of policy formation come to be dominated by distribution rather than efficiency'. Benefits from government intervention will tend to accrue disproportionately to small groups whereas the costs will be spread widely across society: collective goods theory would predict in these circumstances that the beneficiaries of such intervention will have the incentive to organise to press for government action. In the oft-employed metaphor of neoclassical economists, interventionist governments run the risk of opening a Pandora's box whereby government policy will be captured by rent-seeking groups. (Brander 1987: 28; Krueger 1990: 83; Krugman & Obstfeld 1988: 207). As Baldwin (1992: 225) notes: 'Political economy theory would therefore lead us to expect that governments would systematically choose the wrong trade policies'. Rational choice theories, moreover, provide a host of reasons why decision makers in public office will pursue policies that primarily benefit themselves or their organisations rather than the general interest (Stiglitz 1989; Wolf 1988). And, finally, even in the unlikely event that government intervention is successful in improving the short-term welfare of the economy, critics argue that it will probably be counterproductive in the long run because it will provoke retaliation by trading partners adversely affected by these policies.

If our argument, that Japan, Korea and Taiwan all successfully pursued elements of strategic trade policies in certain industries during specific periods of their postwar development, is to be credible, we have to explain why these countries did not always succumb to government failure. Again it is important to emphasise that we are not suggesting that government failures never occurred in these countries: there are examples of these governments picking losers, of their protecting politically important domestic constituencies, and of policy making being captured by rent-seeking interests. But such acknowledgement does not contradict our argument that on other occasions the state has acted strategically and decisively through industrial and trade policies to promote national welfare.

To explain why some states have behaved in a developmental rather than a predatory manner is no mean task. There is always a danger—

as was characteristic of some of the literature on state strength—of lapsing into tautologies which equate the characteristics of the state with certain policy outcomes, and vice versa. An answer to why some Northeast Asian states have successfully pursued developmental strategies requires a multifaceted approach that encompasses characteristics of the state itself, the relationship between the state and the industrial sector, the culture in which the state is embedded, and the environment (strategic and economic—both international and domestic) prevailing at the time such policies were pursued. Taken individually, none of these factors may be necessary, and certainly none are sufficient, to explain the outcome (some of the characteristics, such as elite planning agencies, were present in other countries without leading to similar positive results). Moreover, even when they occur together, the factors do not guarantee a particular outcome—state actors had to make the conscious choice to seize the opportunities available to them.

The development of industrial policy in all three states was led by technocrats located in planning agencies (Johnson 1982, 1987). There were differences between the 'pilot agencies' in the three countries: MITI had the widest range of powers; the Korean Economic Planning Board, established in July 1961 immediately after the military coup of Park Chung-Hee, resembled MITI in its mandate; while Taiwan's Council for Economic Planning and Development lacked the same status as *primus inter pares* among that country's economic ministries (Choi 1987; Wade 1990). But recruitment to all three agencies was highly competitive. The public service as a whole in all of the countries (at least after the overthrow of Rhee in Korea) operated on meritocratic principles, and jobs within the planning agencies were among the most highly sought after. As Vogel (1991: 92–101) and Evans (1989) note, neo-Confucian and Weberian characteristics predominated in these bureaucracies: selected in a highly competitive meritocratic manner and enjoying long-term career rewards, bureaucrats are imbued with both a sense of responsibility for the overall welfare of society and a sense of corporate commitment and coherence.

Because of the centrality of their role in government and the high calibre of their staff, the planning agencies were held in high esteem both within the bureaucracy and within society as a whole. Such agencies were able to overcome the information failure problems pointed to by critics of state intervention, not only because they had their own detailed intelligence about the domestic and international economies, and staff of sufficient calibre to be able to digest such data and engage in rational planning on the basis of them, but also because of their relationship with the private sector. This relationship is best captured by Evans's (1989) idea that the Northeast Asian states were 'embedded' in a specific set of social ties that provided institutionalised channels for the collection and exchange of information and for the 'continual negotiation and renegotiation of goals and policies'.

Yet despite the close working relationships with business, the planning agencies for the most part did not succumb to rent-seeking behaviour. The explanation for this lies in their members' commitment to corporate coherence, the perception on the part of technocrats that career success was dependent on national economic performance, and the ability of the agencies to identify and articulate a clear sense of the national economic interest that gained widespread social acceptance. This insulation from the business sector—the fact that the state is not beholden to individual companies—has afforded it the freedom to discipline individual firms by ensuring that they were subject to the forces of competition, either domestically or internationally. A necessary permissive factor enters the equation here: for the state to act in this manner it must exercise control over key policy instruments such as access to credit, import licences, and tariff protection.

The autonomy of the industrial planning agencies from individual companies, unlike the relationship between other ministries and their clients, has made it less likely that the agencies will succumb to rent-seeking interests. Various administrative arrangements within the agencies may help to enhance this autonomy. Okimoto (1989: 113), for instance, notes that MITI is organised into two types of bureau—'horizontal' (which looks after the economy as a whole) and 'vertical' (which oversees particular sectors)—providing a series of internal checks and balances against particularistic interests. And in Japan MITI does not interact primarily with individual firms but works through industry associations that, in Olson's (1982) words, were more 'encompassing' than 'distributional' in character. Furthermore, it has been suggested that the structure of Japanese business organisations—particularly the horizontal *keiretsu* with their firms representing a variety of different sectors—is itself akin to an encompassing rather than a distributional coalition (Jankowski 1989). A similar argument might be made for the *chaebol* in Korea.

To assert that the state has acted autonomously in the pursuit of strategic trade policies is to argue, in Wade's (1990) terms, that the state at times has pursued a strategy of 'big leadership'; that is, it has intervened to change the pattern of incentives sufficiently to make a 'real difference to investment and production patterns in an industry'. On occasion this has led industry down a path it initially opposed.

Haggard (1990: 39, 40, 98), for instance, records that the move to outward-oriented industrialisation in Korea and Taiwan did not reflect business interests and, indeed, was possible only because the state designed the policy in isolation from such interests. The state has been able to exercise 'big leadership' either because it was able to convince business interests through 'administrative guidance' of the desirability of pursuing a particular course of action, or because it could compel them through the exercise of the policy instruments under its control. There were significant differences between the three countries in the ways in which government and business interacted. These inevitably have affected the modalities of government intervention in the economies. In Japan, administrative guidance was frequently sufficient to ensure that firms pursued the desired policies. In Taiwan, Wade (1990: 321) suggests that the government has used state-owned enterprises and public laboratories to lead the push into new fields, and relies on arms-length incentives to steer the smaller and medium-sized private firms. In Korea, in contrast, the government has relied more on using targeted credit to steer the *chaebol* into particular activities.

Although the state in all three countries at times performed a 'big leadership' role, for the most part the relationship between business and government was a cooperative one (Johnson 1982: 311). Okimoto (1989: 145) concludes his discussion of industrial policy in Japan by suggesting that to perceive government–business relations as a 'Manichean' struggle misses 'the subtlety and complexity of the relationship', a relationship that is not adversarial but based on cooperation in attempting to achieve common goals. Samuels (1987) depicts the Japanese relationship as one of 'negotiated reciprocal consent'. In their study of government–business relations in Korea during the Park regime, Jones and Sakong (1980) argue that because of the dependence of the government on economic performance, and thus on the achievement of private business, a mutuality of interest existed between government and business. That mutuality of interest was reflected in a partnership between the two, albeit an unequal partnership. Amsden's (1990) study of Korean industrialisation stresses the importance of reciprocity in government–business relations: in a direct exchange for subsidies and other discretionary privileges, business complied with the strict performance standards demanded by the government. In all three countries the relationship between the state and business has evolved toward a more equal partnership as the very success of developmental policies has created strong private companies. This has given the latter substantially more autonomy and consequently has reduced the effectiveness of the policy instruments controlled by the state.[4]

When economists write of the political economy problem that they perceive as inevitably accompanying state intervention in the economy they clearly have in mind a pluralist political system (most often, of course, the United States) where legislatures are of importance in the policy-making process, where the state is weak, and where politicians, acting individually or collectively, have the capacity to intervene in policy making to promote particularistic interests. Such images had little resonance in the three countries where, until recently, in Johnson's (1987) aphorism, politicians reigned but bureaucrats ruled. A single party monopolised government in Japan from 1955 to 1993; for most of this period the Diet was ineffective. Korea and Taiwan for most of the postwar period have not only been subject to military rule but have been militarised societies. Until the lifting of martial law in 1987, Taiwan, unlike Korea, did not even make the pretence of being a democratic polity. In all three countries, politicians have become more important in the last decade; this trend has important implications for the autonomy of the state. (On Japan see Muramatsu & Krauss (1984); on Korea see Haggard & Moon (1990) and Moon (1988); and on Taiwan see Cotton (1991) and Wu (1989).)

Organised labour and other social forces that might have opposed the state's industrial policies were effectively excluded from policy making. Haggard (1988: 263) writes of a 'relative vacuum on the left' that was characteristic of politics in South Korea and Taiwan. Groups opposed to reforms were either suppressed or integrated into state-sponsored corporatist organisations (Deyo 1987). The postwar land reforms in the two countries removed the power of the landlord class and reduced the likelihood that the regimes would be subject to rural-based revolts. The Japanese political system has been described as 'corporatism without labour' (Pempel & Tsunekawa 1979), a system in which organised labour has had little effective input into higher level political decision-making.

If the argument is accepted that the success of the state in Japan, Korea and Taiwan was based on its autonomy from societal forces, an explanation is still needed as to why such strong states did not pursue a predatory approach in pursuit of their own interests rather than those of society as a whole. There is a 'statist paradox' to be explained—why those states best placed to pursue predatory policies chose not to do so. A persuasive explanation is to be found in the 'situational imperatives' listed by Johnson (1982: 307), in particular the serious external and, especially in the cases of Taiwan and South Korea, internal threats faced by governments in the early postwar years. Poor natural resource endowments made industrialisation the only possibility for achieving rapid economic growth. State elites in Taiwan and Korea had the benefit of learning from previous mistakes (the Kuomintang from its disastrous experience on the mainland; Korea from the rent-seeking of the Rhee years), and could look to Japan as an economic model to emulate. Yet 'situational imperatives' do not become imperative until they are perceived as such by the state elite. It was the perception that the legitimacy and indeed possibly the integrity of the state, and thus their own political fortunes, were tied to economic performance that was crucial.

In short, a combination of factors caused the three states to pursue a developmental rather than a predatory trajectory. In Evans's (1989) terminology, the state was embedded in a set of relationships—with economic and social actors and with the international economic and security systems—that enhanced state autonomy, improved state capabilities, and facilitated the pursuit of developmental objectives. Yet this conjuncture of domestic and international circumstances did not dictate outcomes: rather, policies were determined by the vision of political elites and their creative response to adverse circumstances.

The final issue to be addressed in this section is the argument that strategic trade policies will not work because 'a country that attempts to use such policies will probably provoke retaliation' (Krugman 1987b: 141), Arguments such as these, typically made by economists, are completely ahistorical and acontextual. The success of the Northeast Asian developmental states owed much to the regional security context of the immediate postwar years (Cumings 1987). In a period when the United States was the undisputed economic hegemon, it was willing to allow the three Northeast Asian economies (as well as those of Europe) to discriminate against its economic interests in order to pursue its security agenda. As the security situation has changed, and the US economy declined relative to that of its major competitors, so the US government has been far less willing to tolerate the employment of predatory policies by its trading partners. Nevertheless, there are other reasons why an automatic retaliatory response to strategic trade policies might not be forthcoming. These include the difficulties of providing sufficient proof to satisfy legal requirements to document the existence of or detrimental effects of such policies; the possibility that the offending state will have domestic allies or effective paid lobbyists in the political systems of its trading partners; or because the offending country does not cast a sufficient shadow in the international trading system to be deemed to be of concern. In any event, retaliation may be counterproductive: the US discovered to its cost that the voluntary export restraint on Japanese cars created windfall profits for Japanese producers, and strengthened MITI's hand in dealing with the Japanese car industry.

CONCLUSION

We have reviewed one dimension of government–business relations in Northeast Asia: how governments have intervened through selective sectoral policies to provide support that has enabled businesses to undertake activities that would not have been possible if dependent on the firms' own resources. These policies have been consistent with prescriptions that can be drawn from the literature on strategic trade theory. We have also suggested why the interventionist policies pursued by the governments of Japan, Korea and Taiwan did not succumb to state failure as often as neo-liberal critics of state intervention have argued would occur.

In the first section of this chapter, we identified four variants of strategic trade theory. In these different variants, government intervention is asserted: to foster rent-shifting by enabling firms to make credible commitments; to help firms to realise scale and learning economies by providing protection of the domestic market and/or by facilitating exports; to assist in the realisation of externalities; and to set economies on a more beneficial technological trajectory than would otherwise have occurred. To what extent do the experiences of the three Northeast Asian countries substantiate these various strategic trade arguments?

Not surprisingly, there is little evidence in our three cases of game-theoretic-type strategic actions along the lines of the original Brander/Spencer formulation of strategic trade theory. For, even leaving aside the contentious issue of whether there are significant rents to be gained from such interventions, the conditions under which such action would be possible are rare, particularly for countries that are not at the technological frontier. The game-theoretic variant of strategic trade theory assumes that industries susceptible to government intervention are characterised by a very small number of producers, substantial barriers to entry, and significant economies of scale. Although the number of such industries undoubtedly is increasing as the costs of research and development escalate, and global alliances between firms become commonplace, they are still relatively uncommon and, perhaps more importantly, not the type of industries that countries can enter unless they are already close to the technological frontier. Government commitments would only be credible to potential rivals if domestic companies have already acquired substantial capabilities in the relevant industries. Such actions would not be expected, therefore, in economies that are passing through the early stages of industrialisation. Accordingly, game-theoretic strategic commitments figured in our cases, it was after a substantial industrial and technological base had been established. Most of the examples are from Japan, especially in the semiconductor industry. There is also some evidence to suggest that government commitments have enabled Korean companies to enter the semiconductor industry, and to drive out Japanese producers from the low end of the market.

More prevalent have been actions in accord with the variant of strategic trade theory that builds on the infant industry argument to suggest that government intervention through protecting the domestic market and through facilitating exports may enable firms to capture the benefits of scale and learning economies. The larger the domestic market, the greater the potential for realising such benefits. Japanese companies thus have tended to benefit more than their Korean counterparts, which in turn benefited more than Taiwanese firms, from having a secure home market (although it should be noted that in most industries in Japan there has been vigorous competition in the protected domestic market between a number of companies, whereas Korea and Taiwan in some sectors have granted companies domestic monopolies). Governments in all three countries have also, however, utilised various policy instruments to enable domestic firms to realise scale and learning economies through penetrating foreign markets.

The third and fourth variants of strategic trade theorising both build on the notion of realising externalities, and we will consider them together here. Our case studies show many examples in all three countries where government intervention in the form of sectoral trade and industry policies has occurred with the intention of realising externalities, of changing technological trajectories, and of shaping comparative advantage. None of the governments has been content to entrust the course of economic development exclusively to the market. All three have consciously targeted industries that were perceived to be strategic for the economy's future growth—industries that were skill- and capital-intensive, industries that were expected to generate technological spillovers and other externalities, and industries whose products were identified as having high income elasticities of demand. A similar set of industries was identified for government support in all three countries—steel, heavy and chemical industries, automobiles, electrical and electronics, semiconductors and, most recently, bio-technology. The similarity in the industries assisted is unremarkable given, first, the importance of these sectors to modern industrialised economies and, second, the fact that both Korea and Taiwan consciously set out to emulate the Japanese model.

Various policies have been used to overcome factors such as coordination and information failures that prevent externalities from being realised. Again, there are great similarities across the three countries. Governments have sponsored research and development activities designed to acquire and disseminate foreign technologies; they have used their powers over foreign investment to require technological transfer and/or to insist that foreign investors take on local joint venture partners. The net result was to shift production to the local economies, production that would otherwise have been carried out overseas. A remarkable feature of the three countries was the relatively small role played by transnational corporations

In short, the state has intervened decisively in Japan, Korea and Taiwan at various times to change the structure of incentives for particular industries in a manner that has significantly affected their patterns of economic development. Conclusions about the replicability of this experience with strategic trade policies must, however, be drawn cautiously. We have argued that the success of the policies pursued by these states depended on the political and institutional contexts in which they were applied. To avoid state failure in the pursuit of similar policies in political systems that lack the normative consensus, the exclusionary characteristics and/or the weak legislatures of Japan, Korea and Taiwan will be much more difficult. Similarly, to reproduce the elite planning agencies of these countries elsewhere, without the supporting political and economic environments, is to invite very different results. This is not to say that there are no possibilities for the construction of functional equivalents to the development-promoting Northeast Asian structures and agencies, but rather that other countries will have to devise their own structures rather than mimic those from an alien context (Haggard & Moon 1990).

These qualifications about the application of strategic trade policies notwithstanding, there does appear to be potential for other countries to benefit from similar policies. As we have seen, such policies are most likely to be successful when countries are still at the catch-up stage, a considerable way behind the technological frontier. For one thing, market failures are more likely to be a feature of less advanced economies. For another, as economies mature, the instruments of intervention available to the state lose their effectiveness as corporations gain increasing autonomy. And such policies may be all the more important in an increasingly integrated global economy. There is now intense competition between a growing number of economies seeking to become next-generation NICs. One dimension of this competition occurs in bargaining with transnational corporations for a share in the global production process. State intervention to enhance the benefits that domestic economies gain from participation in global production chains may be decisive in determining the technological trajectories that countries will follow. States which fail to intervene to promote industries that generate externalities that can be captured by the domestic economy will be in danger of missing out in the struggle for economic growth.

NOTES

1 'Calibration', in Richardson's words (1989: 19), 'amounts to making the assumed behaviour and one period's data mutually consistent'. As Krugman (1986: 661) acknowledges: 'the gimmick is to specify the model so that the number of free parameters and the number of discrete pieces of data are the same. This means that [a calibrated model] is empirical work only in the sense that the data is allowed to determine some of the results. The data is not given a chance to reject the model'. Calibrated studies, in other words, have a number of very significant weaknesses and their results are very dependent on the parameters estimated by the researchers. Richardson (1989: 22) lists their defects as 'simplicity, judgemental use of data and econometric estimation, insistence on maintaining rather than testing hypotheses, and imprecise statistical robustness' and concludes that 'calibration/counterfactual models are more art than science'. Despite Krugman's (1992: 434) admission that 'Nobody really believes in the calibrated results', they continue to be widely cited by critics of strategic trade policy (*The Economist* 1990, for example).

2 Two calibrated studies that do report positive results from strategic trade policies are Daltung, Eskeland & Norman (1987) and Baldwin & Flam (1989).

3 The most comprehensive presentation of this approach may be found in Dosi, Pavitt & Soete (1990); one of the more accessible treatments is Dosi, Tyson & Zysman (1989); see also Pack & Westphal (1986). The approach builds on the work of theorists of technological change such as Nelson & Winter (1982), and Mowery & Rosenberg (1989).

4 In Wade's (1990: 28) terminology, the relationship between business and government in the three Northeast Asian countries may have been characterised more frequently by big followership than by big leadership. Big followership refers to situations where government policies enable firms to undertake activities that they themselves wished to initiate but which they are unable to finance from their own resources. For the purposes of qualifying as strategic trade policy, however, it is immaterial whether governments 'lead' or 'follow'—the key question is whether the sectoral policies pursued produce outcomes that would not have occurred if left to market forces alone.

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3 Between the State and the Market: the Case for Eclectic Neoclassical Political Economy

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Can governments correctly anticipate shifts in comparative advantage, mould the preferences of the private sector (the 'market') and pick a 'winning industrial structure'? To many political scientists, area specialists and some economists—a group that one could refer to as 'statist political economists'—the answer is unambiguous. The state can, under particular circumstances, 'pick winners' and the experience of the dynamic economies of Northeast Asia and Singapore provides ample support for this view. Statist political economists have found unexpected support from some trade theorists (e.g. Brander & Spencer 1985; Krugman 1984). Using formal economic models they have shown that, under certain conditions, interventionist government policy can create comparative advantage in favour of some industries and thus establish national champions in the international marketplace. This conclusion has spawned the basis of the theory of strategic trade policy.

Mainstream neoclassical economists have typically responded to the implications of strategic policy by suggesting that the supposed benefits of state intervention in order to 'pick winners' are subject to serious political limits, given that such benefits can be easily nullified by rent-seeking behaviour. They have also taken much delight in pointing to the fact that even the originators of strategic trade theory concede that rent-seeking behaviour is the fundamental constraint on the efficacy of interventionist policy (Corden 1991). Certainly, subsequent reflections by Krugman—one of the pioneers in this field—on this issue confirm such an interpretation (Krugman 1987).

The apparent consensus within the economics profession on the political limits to strategic trade policy conveys an intriguing implication: if the state can somehow restrain rent-seeking behaviour by aligning the preferences of the private sector with the preferences of policy makers, then there is no reason to suppose that interventionism will not work. Statist political economists have capitalised on this implication to suggest that the reason why strategic trade policy is so successful in Northeast Asia—and does not seem to be effective elsewhere—has to do with the unusual capacity of the Northeast Asian state to mould the preferences of the private sector in line with the preferences of policy makers (Amsden, 1990, 1991; Wade 1988, 1990; Johnson 1987; Lee & Naya 1988; Lee 1992). Apparently, this seems to pose a major intellectual challenge to the basic tenets of what Srinivasan (1985) has called 'neoclassical political economy'.

The position taken by this paper is that the statist perception of Northeast Asian economic success has important analytical limitations. Neoclassical political economy, appropriately interpreted, is a broad-based, coherent body of economic theory and its basic premise is still valid despite the 'counter-revolution' of political economists working within the statist tradition. In pursuing this agenda the paper goes back to first principles, carefully delineating the salient features of neoclassical political economy and identifying the key aspects of statist political economy. It then proceeds to offer a wide-ranging critique of the statist view of Northeast Asian economic development. This critique is reinforced by drawing upon some recent evidence put forward by political scientists in the context of Japanese industry policy. The evidence tends to show that policy makers often do not have an informational advantage over the private sector in anticipating sources of international competitiveness of an economy. Moreover, the private sector has the capacity to undermine the effectiveness of microeconomic interventions by the state, if the objectives of such interventions do not broadly coincide with the interests of business groups. In sum, the chapter restates the case for neoclassical political economy as a valid analytical approach to understanding the sources of rapid economic development in Northeast Asia.

NEOCLASSICAL POLITICAL ECONOMY AND NORTHEAST ASIA

Neoclassical political economy is largely inseparable from public choice theory (Mueller 1989, 1991; McLean 1987, 1991). Models in the public choice theoretical tradition focus on the constant tension between 'market failure' and 'government failure'. As is well known, market failure may be described as a situation where private economic decisions of utility-maximising households and firms do not generate socially optimal outcomes. This can stem from a number of sources:

externalities, public goods, monopoly elements, imperfect information and transactions costs. As has been argued since the time of Adam Smith, the rectification of market failure represents the primary intellectual case for government intervention in the economy.

The notion of market failure has played an important role in the evolution of development studies as a distinct intellectual discipline. The pioneers of the subject often characterised an underdeveloped economy as a case of endemic market failure (Bhagwati 1984). It is now widely recognised that the fatal flaw in this view was the incorporation of an implicit model of the state in which benevolent 'preceptors' (political leaders, key bureaucrats) could costlessly mitigate market failure. The paradox that the rectification of market failure could be nullified by government failure was not appreciated. It thus follows that a central element of development studies ought to be the formation of theories on the sources of, and potential solutions to, government failure. This is the domain of neoclassical political economy.

There are two principal sources of government failure in neoclassical political economy. First, a public-interest-driven policy agenda can be subverted by the rent-seeking propensities of the private sector. Second, predatory behaviour of state officials can lead to a degree of state intervention that is in excess of the socially optimal level. Another plausible source of government failure is represented by what may be loosely described as administrative incompetence. One could argue that even if a polity is well endowed with bureaucrats motivated by the need to serve the public interest, lack of sufficient training can lead to a limited capacity to interpret and enforce rules. It seems that administrative incompetence of this sort has received insufficient attention in the neoclassical political economy literature, so that it is best to focus on the rent-seeking behaviour of societal groups and state-led predation in discussing the relevant theory.

The essence of rent-seeking models in neoclassical political economy can perhaps be best exemplified by focusing on a particular example. Suppose that the central policy-makers of a hypothetical low-income country are able to establish a generic class of market failure in the sense that there is underinvestment by the private sector in a 'socially desirable' industry (e.g. a 'high-tech' industry). The state then decides to engage in strategic trade policy by 'targeting' this industry as a priority investment area and tries to achieve this aim through a complex array of policy instruments. Thus it offers subsidised credit, restrains competing imports through a combination of tariffs and quotas, regulates entry to the industry by issuing licences to a limited number of firms and provides a captive market for the products of the industry through its procurement policies. The net effect of these policy interventions is to create monopoly rents or scarcity premiums. The presence of such rents can induce responses among private sector participants that go beyond the public interest objectives of the policy makers. Thus the private sector could form 'distributional coalitions' (Olson 1982) and engage in lobbying activities designed to capture the rents. These rent-seeking activities—which can range from lobbying within legal limits to outright bribery and corruption—are unproductive in the sense that while they yield income or profits to private interests they do not produce goods or services that add to societal output (Bhagwati 1982). Even worse, a vicious cycle may set in: an initial policy intervention creates monopoly elements which then become entrenched and oppose change and reform, and in fact induce further policy interventions that create cumulative monopoly rents. State activism thus engenders cumulative inefficiencies that retard economic development. Some crude estimates suggest that policy-induced rent-seeking costs may be as high as 15 per cent of GNP (Krueger 1974).

The notion of state-led predation as a source of government failure is prominent in the contributions of Niskanen (1971) and Brenan and Buchanan (1980). Niskanen suggests that bureaucrats are driven not by the need to serve the public interest, but by budget-maximising considerations. Brenan and Buchanan conceptualise the state as a revenue-maximising monopolist. The Niskanen/Brenan–Buchanan types of analysis have evolved in the institutional context of advanced industrial countries. Killick (1989) has drawn attention to the fact that Lal (1984), Findlay (1988) and Wellisz and Findlay (1988) have applied the theory of the predatory state to developing economies. The general conclusion is that predatory states are characterised by pervasive and inefficient intervention in the economy.

Neoclassical political economy has thus made a useful contribution to the development literature by offering a well-developed theory of market failure. There has, however, been an unfortunate tendency among many observers working in this tradition to make the unwarranted inference that government failure is common, while market failure is rare and exceptional. Variants of this view are reflected in the writings of Lal (1983), Bauer (1972, 1984), Krueger (1990) and Wolf (1982). Krueger (1990: 9) summarises this position in the following manner:

> The fact is that, by the 1970s and early 1980s, governments in many developing countries were mired down in economic policies that were manifestly unworkable. Whether market failure had been present or not, most knowledgeable workers concluded there had

> been colossal government failure. In many countries, there could be little question but that government failure significantly outweighed market failure.

This empirical position cannot, however, be elevated to the status of a general analytical proposition. Stiglitz (1990: 37) notes that '. . . in general the assertion that the government can do no better than the market is false'. Hence the key policy and political challenge is to seek institutional arrangements that minimise both government failure and market failure.

The normative issue of resolving government failure has sometimes been inappropriately represented by writers in the neoclassical tradition. Lal (1983: 33), for example, gained notoriety for saying: 'A courageous, ruthless, and perhaps undemocratic government is required to ride roughshod over . . . special interest groups'. This prompted Shapiro and Taylor (1990: 867) to suggest that 'neoclassical authors lean towards authoritarianism as a device to preclude special interests from taking over the state'.

A careful enunciation of the neoclassical principles of 'good' governance implies that the Shapiro–Taylor position is highly selective. Authoritarian political management is irrelevant in delineating the appropriate role of the state in the economy. There is a broad consensus among neoclassical writers that the state should operate within carefully prescribed limits. Thus:

1. The state should primarily allow market-based, private-sector-driven initiatives in the mobilisation and allocation of resources to growth promoting activities.
2. The state should intervene only in cases of clearly established market failure (i.e. in cases where private sector operations do not correspond to societal interests).
3. Even in cases of proven market failure, the appropriate policy responses should be parametric measures (such as lump-sum taxes and subsidies) as well as incentives that establish a private market (such as a venture capital market).
4. The state should provide 'pure public goods' (law and order, national defence, public infrastructure) including the proper assignment and enforcement of property rights.
5. The state should provide a stable and predictable macroeconomic environment through appropriate coordination of fiscal, monetary and exchange rate policies.
6. The state should enforce a free trade (or almost free trade) regime on the ground that such a 'neutral' policy regime restrains the government from making sector-specific interventions (Krugman 1987; Lal and Rajapatirana 1987).

If the state broadly conforms to the limits set by these prescriptions, then society can realise a range of benefits: reduction in the information burden placed on policy makers, conservation of scarce administrative and managerial talents, restraints on predatory behaviour, and a reduction in the risk that state officials will be prone to 'capture' by special interest groups. If, on the other hand, the state progressively exceeds the limits set out above, then eventually government failure will occur which will more than offset the alleged inadequacies of the private sector. Exactly how these prescriptions of good governance should be enforced remains an open question, although Brenan and Buchanan (1980) have suggested in the context of mature democracies that, given the imperfect constraints of competitive politics on inefficient *dirigiste* states, constitutional restraints may well be necessary on the fiscal, debt and money creation capacities of the government.

In applying these ideas to the dynamic economies of Northeast Asia the adherents of neoclassical political economy would argue that, by relying on the private sector and free trade, these countries have been able to minimise government failure so common in other countries. Hence, this is the key reason behind their dynamic economic growth. Little (1979, 1981, 1982) and Balassa (1981) are two prominent proponents of this view, although their analyses are not couched explicitly in political economy terms.

STATIST POLITICAL ECONOMY AND NORTHEAST ASIA

Neoclassical political economy has undoubtedly established itself as a dominant paradigm in development economics. However, a growing body of research on the role of the state in economic development has begun to question the tenets of neoclassical political economy. One may attach the label of 'statist political economy' to this literature for ease of reference. Its primary aim is to highlight the notion of the state as an engine of growth.

This section delineates the key features of statist political economy. It is necessary to emphasise that the interpretation of statist political economy offered here adopts an analytical framework that is flexible enough to highlight nuances in the literature.

The starting point of statist political economy is that '. . . the rent-seeking literature is better at explaining failures . . . rather than success stories, particularly of state-led industrialisation, and there have been some dramatic cases of the latter . . .' (Bardhan, 1990: 5). Like neoclassical political economy, statist political economy draws its inspiration from Northeast Asia. It contends that at the core of

Northeast Asian success lies enlightened policy activism of national governments.

Advocates of statist political economy are keen to point out that the Northeast Asian economies have been as interventionist as some of the less successful developing countries (e.g. some of the Latin American economies). Thus, for example, the weight of the government in the economy measured in terms of the share of GDP in state enterprise is apparently greater in Taiwan and South Korea than in many Latin American countries (Sachs 1985). A more searching analysis of regulatory mechanisms in Northeast Asia (e.g. the regulation of the financial sector) suggests an equally pervasive presence of the state (Wade 1988, 1990). This has led to the growing realisation that what matters in the process of economic development is not the extent of intervention but the quality of such intervention (Bardhan 1990; Sen 1983; Sachs 1985).

As a prelude to discussion of the salient features of statist political economy, it is useful to look at extreme cases of variations in state capacity. These cases are meant for illustrative purposes only and should be interpreted in the same spirit as Evans's (1989) analytical constructs for delineating the spectrum of state capacities in the developing world. At one extreme lies the ideal-type 'developmental state'. Such a state is able to achieve 'relative autonomy' from the contending pressures of distributional coalitions; it is well endowed in terms of administrative competence and does not exhibit predatory behaviour because of the commitment of policy makers to a coherent development vision. At the other extreme is a generic class of 'non-developmental states' where state officials are prone to 'capture' by special interest groups, where state-led predation is common and where government failure is compounded by administrative incompetence. A testable hypothesis is that there is likely to be a systematic relationship between economic performance and state structures, with rapid growth being more probable in developmental states than in alternative regimes.

One could argue that policy-making processes in Northeast Asia provide a reasonable approximation of the ideal-type developmental state. As pointed out by Onis (1991), the epithet 'capitalist developmental state' was first applied to a Northeast Asian context by Johnson (1982) in his exploration of the institutional bases of Japanese economic growth. He subsequently extended the label to describe policy-making arrangements in Korea and Taiwan (Johnson 1987). Johnson suggested about seven characteristics to describe the developmental states of Northeast Asia. Closer inspection reveals that some of the suggested characteristics overlap, while others (e.g. role of business conglomerates, state control of bank finance) represent country-specific, rather than general analytical, categories. Thus one could depict Johnson's model in more parsimonious terms and suggest the following set of features of Northeast Asian developmental states:

1. An elite bureaucracy (such as the Ministry of International Trade and Industry, or MITI, in Japan) staffed by the best managerial talent in the system.
2. An authoritarian political system in which the bureaucracy is given sufficient scope to take policy initiatives. This in turn entails the political exclusion of the labour movement.
3. Relatively close government–big business interactions.

These features protect Northeast Asian policy makers from the ravages of distributional coalitions, while at the same time they limit the predatory behaviour of state officials through the inculcation of a coherent development vision. Commentators vary in terms of the importance that they attach to the above features. Thus, for example, Deyo (1987, 1989) highlights the political exclusion of the labour movement, while Amsden (1990), Lee (1992) and Lee and Naya (1988) focus on the nature of government–business relations.

It is also necessary to point out that there seem to be two versions of the developmental state hypothesis. In the case of one—call it version 'a'—the argument seems to be that authoritarian political management paved the way for the implementation of neoclassical policies. In the case of the other—version 'b'—the contention seems to be that aggressive, sector-specific interventions, rather than neoclassical policies, lie at the core of economic management in Northeast Asia. It seems that version 'a' is reflected in the writings of Haggard (1986, 1988, 1990), while version 'b' can be detected in the writings of Wade (1988, 1990), Amsden (1990, 1991), Lee (1992) and Lee and Naya (1988). Thus Wade (1990) depicts a 'governed market hypothesis' in which the process of industrial adjustment is characterised by pervasive market failure. The state can mitigate market failure problems by anticipating shifts in comparative advantage. This in turn leads to the point that the consistent application of strategic trade policy can foster national champions in international markets.

Amsden (1990), focusing on the specific case of South Korea, posits a model of 'late industrialisation' where policy makers face a Gerschenkronian compulsion to force the pace of industrialisation by pervasive manipulation of the structure of relative prices, in particular through the allocation of subsidised credit to targeted firms and industries. Northeast Asian states represent 'special cases' of late industrialisation because of the unusual capacity of policy makers to impose discipline on subsidy recipients. A broader depiction of this argument can be found in the contributions of Lee (1992) and Lee and Naya (1988) in their model of the 'quasi-internal organisation' (QIO), on which more later.

One could argue that version 'a' of statist political economy extends the neoclassical interpretation of Northeast Asian economic success (Doner 1992: 398). In other words, writers in this tradition agree with the position of economists in suggesting that Northeast Asian success depended on the effective implementation of neoclassical policies, but they extend the analysis significantly by highlighting the political framework of policy making. This is a valid observation, but an important caveat needs to be attached. As noted, the implication that authoritarian political management is essential for the implementation of neoclassical policies is false.

Version 'b' of statist political economy is more problematic as it apparently poses a challenge to neoclassical political economy. The rest of this discussion focuses on the QIO model as a prelude to the development of a critique of statist political economy. Such a focus may seem unduly restrictive, but there are a number of cogent reasons for adopting the approach.

To start with, Amsden's model is theoretically underdeveloped. Attempting to explain Northeast Asian states as 'special cases' by reiterating their institutional features runs the risk of self-fulfilling description. Similarly, in the case of Wade, the important point that the process of industrial adjustment is characterised by pervasive market failure restates the standard intellectual foundation for government intervention, but cannot resolve the appropriate form of such intervention. A Wade-type position is vulnerable to the rebuttal that one cannot demonstrate the inherent superiority of sector-specific intervention over parametric intervention in mitigating market failure.

It thus seems that one should proceed from first principles in explaining the unusual policy implementation capacities of Northeast Asian states. The Lee–Naya contributions fit this requirement to the extent that there is a conscious attempt to forge links with analytical innovations in mainstream economic theory (in the specific form of transactions cost economics). In addition, as will be argued in greater detail later, one can detect conceptual similarities in the writings of other statist political economists to the QIO paradigm, although they do not explicitly use the QIO label. In sum, a focus on the QIO paradigm is not a highly selective interpretation of statist political economy, but a basis for accommodating a variety of views in an analytically coherent manner.

Lee and Naya (1988: S144) introduce their model by arguing that '. . . it has been noted that in East Asia the bureaucracy is highly trained, efficient and so forth, but the existence of such bureaucracy does not mean that markets would not have done better with only indirect government intervention'.

Such logic allows Lee (1992) and Lee and Naya (1988) to focus on government–business relations as the key feature of Northeast Asian developmental states and to suggest that they are best viewed as QIOs. There are two variants of the QIO: one in which the state operates an 'internal capital market' and channels subsidised credit to carefully targeted firms and industries; and another in which the state develops a subtle network of long-term ties with the corporate sector. Both versions bear a tangible resemblance to the writings of other statist writers. Thus Amsden's (1989) model, emphasising selective credit allocation by the state to the private sector, can be easily reinterpreted in terms of an internal capital market. Similarly, Wade's (1988) description of Northeast Asian financial systems as state-based credit systems can be readily restated as internal capital markets.

The notion of the 'network' state was first used by Okimoto in his account of Japanese political economy. Japan is conceptualised as a quintessential 'network state, one whose strength is derived from the convergence of private and public interests and the extensive network of ties binding the two sectors together' (Okimoto 1989: 145). The network ties are usually of an informal nature, but in many cases they are reinforced through a variety of institutional arrangements. Thus, for example, 'discussion councils' provide a forum for private and public sector personnel to exchange views and opinions on the future course of the economy and society. One may also mention the practice of *amakaduri* in Japan, whereby senior civil servants move into the boardrooms of large private organisations after retirement (Whitehill 1990).

The thrust of the discussion is thus that while Okimoto does not specifically use the QIO paradigm, his concept of the network state belongs to the same genre. It now remains to be shown why the QIO as an institutional arrangement is optimal in terms of economic policy making. Once this hypothesis is established it is possible to argue that, given that the Northeast Asian state is organised as a QIO, it will be able to effectively implement strategic trade policy—and generate correspondingly superior economic performance compared with non-QIO regimes in other countries.

In explaining the efficacy of the QIO, Lee (1992) and Lee and Naya (1988) derive their intellectual inspiration from transactions costs economics at the core of which are the contributions of

Williamson (1975, 1985). Williamson considers internal organisations, of which the private firm is a prime example, and the market as alternative institutional modes for organising the exchange of goods and services (including such intangibles as knowledge and technology). He identified a generic class of 'market failure' (i.e. where the market is not efficient in organising transactions) which is conceptually distinct from the familiar ones of externalities and monopoly imperfections. All transactions are characterised by either implicit or explicit contractual arrangements. There are both ex-ante and ex-post costs of negotiating, implementing and enforcing contracts. These 'transactions costs'—which can be particularly acute for complex exchange, such as transfer of technology—stem from bounded rationality and opportunistic behaviour. The former pertains to the notion that individual economic agents have a limited capacity to comprehend and foresee all possible contingencies. The latter pertains to the notion that parties to a contract tend to exploit asymmetric information to their advantage.

In the presence of pervasive transactions costs, 'market failure' is common. The internal organisation—such as a firm—may be seen as a response to 'market failure'. Thus '. . . profit seeking firms internalise transactions when by doing so the costs of organising and transacting business will . . . be lowered' (Teece 1986: 23). It is in this sense that internal organisations like firms are more efficient than the market.

It is important to note that not all internal organisations will be equally efficient. Thus, as firms become large through progressive internalisation of transactions, owners necessarily have to delegate control to professional managers. This creates conditions for 'organisational failures', as managers engage in opportunistic behaviour to pursue goals that do not necessarily maximise profits. Williamson argued that the firm itself will respond to organisational failure by changing its internal organisational design into an M-form (multidivisional) structure. A stylised characterisation of the M-form firm is as follows:

1. It has a corporate head office which oversees a set of quasi-autonomous operating divisions.
2. The head office is principally concerned with strategic decisions involving planning, appraisal and control, while operating decisions fall within the domain of the divisions.
3. In carrying out its functions, the head office performs the role of an internal capital market in the sense that funds are allocated to competing divisions on the basis of high-yield use.
4. The internal capital market role of the head office is supported by

control and incentive machinery. Control mechanisms include such measures as regular internal audit to identify below-average performance, while incentives such as salaries, bonuses etc. may be used to reward performance consistent with corporate goals.

5. The efficacy of the internal capital market function of the head office is greatly assisted by the fact that, given the quasi-autonomous standing of the divisions, the contribution of each division to corporate-level profit can be easily observed and measured. As a result, top executives can measure performance on the basis of profit criteria.
6. Finally, the separation of operating and head office functions provides executives with a psychological commitment to overall performance of the organisation.

The detailed depiction of Williamson's M-form hypothesis leads to a fundamental point: the M-form firm is more efficient than both the market (which is afflicted by transactions-cost-related market failure) and firms not organised along M-form lines (which are afflicted by organisational failure).

The Lee–Naya version of the QIO paradigm attempts to apply the Willliamson theory of the firm to the Northeast Asian state and tries to draw equivalent normative implications. Thus, when the state is organised as a QIO, the role of the centralised policy maker becomes equivalent to the role of the head office, while the role of the business groups becomes equivalent to that of the divisions.

How do the policy makers maintain control over the corporate sector and ensure that it adheres to state-articulated goals? Once again the control and incentive machinery are rather similar to the M-form firm. Thus, for example, policy makers perform internal audits on the corporate sector through tax audits. More importantly, the government operates as a vast internal capital market by allocating funds to key corporate clients. These funds are in effect subsidised credit provided to 'targeted' business groups. In order to ensure efficiency, the state needs to impose performance standards on subsidy recipients. This suggests the use of performance targets which can be functionally related in a direct, observable manner to central development goals. If, as in Northeast Asia, the centralised policy makers are committed to economic growth via export growth, the use of export targets closely tied to the allocation of subsidised credit appears to be a logical choice.

Having established the similarity between the QIO and the M-form enterprise, the proponents of this paradigm note:

> . . . given the modern multi-unit enterprise is an efficient institu-

tion . . . it follows that the quasi-internal organization can be efficient in achieving its objectives (Lee 1992: 13).

One can also apply the broad principles of transactions cost economics to the network state. Thus, the network state can minimise government failure by creating an atmosphere of trust and cooperation between key state and societal actors and thus reduce the transactions costs of policy making.

Finally, one can draw an analogy between the efficiency of the QIO and Olson's principle of encompassing organisations (Olson 1982, 1986). Olson contends that not all distributional coalitions are counterproductive. If they are organised as broad-based groups or encompassing organisations, then they are more likely to align societal interests with private interests than are narrowly based distributional coalitions. Narrowly based groups have an incentive to engage in 'zero-sum activities': their gain is another group's loss. Encompassing organisations, on the other hand, do not have a similar incentive to engage in zero-sum activities. Given their weight in the economy, the larger the societal output the greater is the gain for an encompassing organisation. In terms of Olson's model, Northeast Asian QIOs may thus be seen as encompassing organisations.

A CRITIQUE OF STATIST POLITICAL ECONOMY

The statist political economy of Northeast Asia has made a useful contribution to the greater understanding of the policy process and politics that underpin any successful development strategy. In making such a contribution, it has clarified the misleading nature of the more strident and uncritical neoclassical interpretations of Northeast Asian economic success. Yet, in many respects, recent versions of the statist political economy of Northeast Asia overstate their case. This point is established by highlighting several analytical deficiencies of the approach.

To start with, one may note that the QIO as a 'network state' is a nebulous concept. This is because the dense organisational network that is supposed to exist between the policy makers and the private sector is primarily of a subtle and informal nature and hence not readily observable. While this does not necessarily invalidate the QIO paradigm, it does highlight a major methodological weakness of the theory in the sense that its key propositions are inherently difficult to falsify.

The QIO as an internal capital market is an empirically tractable notion, but it does not really apply to all the Northeast Asian economies. In terms of accuracy of institutional details, the QIO as an internal capital market only has clear relevance in the case of South Korea. QIO proponents would probably acknowledge readily that contemporary Japan, along with Singapore, do not fit. The Taiwan case is more debatable, with Wade (1990) arguing in favour of the hypothesis (or, more accurately, its equivalent version), but Cheng's (1991) analysis of the Taiwanese financial system suggests a somewhat different picture. Even within South Korea the internal capital market model is historically specific, being more applicable to certain periods than to others. Certainly, South Korean policy makers tried to use their control of the financial system to allocate credit to priority sectors during the 1970s. However, the government tried to reduce its role as an internal capital market during the 1980s by attempting to deregulate the financial sector.

The validity of the statist approach to economic development cannot be separated from the role of foreign trade and the way it shapes state autonomy. In their eagerness to construct the hypothesis of the state as an engine of growth, statist political economy theorists sometimes imply that foreign trade—in the specific form of export-oriented policies—plays a superficial role in economic development. Yet they also argue that the reason policy makers in Northeast Asia managed to maintain efficient policies had to do with the foreign trade dependence of their economies (Lee 1992; Wade 1988). In other words, once policy makers became aware that domestic economic fortunes were closely linked to export growth they were constrained from making persistent policy mistakes. If this is the case, then export orientation plays a primary role in Northeast Asian economic development, with state activism playing a supplementary role—an implication that runs contrary to the central arguments of statist political economy.

It is by no means clear that hierarchies—of which the QIO is one prominent example—are efficient, despite the elaborate justifications that one can offer in terms of Williamson's theory of the firm and Olson's principle of encompassing organisation. Both justifications are suspect. Olson (1982) has himself expressed strong reservations about the efficacy of encompassing organisations—a point that will be reiterated later.

Reverting to Williamson's theory, one may note that Hill (1985, 1988) has assembled evidence to show that M-form firms do not generate economic performance consistently superior to other organisational modes. Sah and Stiglitz (1985, 1986, 1988) and Sah (1991) have developed a more general critique of the proposition that hierarchies are efficient. The argument depends on the premise: 'Human judgements are fallible. This often contributes to acceptance of bad projects, policies, and ideas, and a rejection of good ones' (Sah 1991: 67).

The essence of a hierarchy is that it has a small number of preceptors (politicians, bureaucrats and planners in the context of the state; managers and entrepreneurs in the context of firms). The performance of a centralised society (entailing a small number of preceptors) will be highly sensitive to the differential abilities of preceptors (e.g. Idi Amin of Uganda vs Park Chung-Hee of Korea). Given that some preceptors are more fallible than others, it follows that 'more centralised societies will have more volatile performances' (Sah 1991: 71).

Olson makes a very similar point when he emphasises the inherent instability of encompassing organisations. As he notes:

> If a political system is composed only of highly encompassing organisations and institutions, there may be less diversity of advocacy, opinion and policy, and fewer checks on erroneous policies and ideas. Encompassing organisations may therefore perform unusually badly in some periods and unusually effectively in others. (Olson 1982: 52.)

Sah (1991) has extended his critique of hierarchies to corporate governance. He has argued that hierarchical firms exhibit a high probability of rejecting innovation-oriented projects compared with more decentralised firms. If an economic system has a greater incidence of hierarchical firms, then the implication is that dynamic efficiency may be retarded through the inhibition of innovation at the level of the firm.

The elaborate critique of hierarchies is meant to highlight a major lacuna in the QIO paradigm in particular and in statist political economy in general: preoccupation with the efficiency aspects of a Northeast Asian system of governance can easily lead one to overlook its potential problems. The point is that one needs to be conscious of the fact that a developmental state may well be a historically specific phenomenon, relevant in some periods but less relevant in others. As a socio-economic system becomes progressively complex the developmental state—as a prototype hierarchy—may perform poorly, largely because it lacks the risk diversification inherent in decentralised political systems. In fact, some advocates of the developmental state hypothesis have anticipated this problem. Lee and Naya, for example, are apprehensive that the QIO may be more prone to organisational failure as an economic system becomes more complex. As they note:

> It is important to point out . . . that the quasi-internal organization is not relatively efficient under all circumstances. As the economy grows and as the number of enterprises increases within the

organization, it will run into more 'internal organizational failures', increasing the cost of policy implementation. Moreover, as the economy graduates from producing simple labour-intensive products, choosing right industries to promote will become more difficult. Consequently, the quasi-internal organization is more likely to make mistakes of choosing wrong policies than before. (Lee & Naya 1988: S147.)

BEYOND STATISM: SOME EVIDENCE FROM JAPAN

Given the above observations, is it possible to draw firm conclusions about the role of the state in Northeast Asian economic development? One may proceed to do so by drawing upon some recent evidence put forth by political scientists in the context of Japan.

It is true that some early work on Japan gave rise to interpretations which were quite consistent with a QIO perspective. For instance, Johnson (1982) popularised the notion that the elite bureaucracy—in the form of MITI—was the prime architect of the Japanese economic miracle. And Wade (1988), drawing upon the work of Zysman (1983), characterises Japan as a clear case of an 'internal capital market' with enormous capacity to intervene successfully in favour of particular industries. However, recent interpretations of economic policy making in Japan have cast serious doubts on this popular view. One could start with the work of Okimoto, who provides only cautious support for the QIO hypothesis. He indicates that it is misleading to characterise the contemporary Japanese state as an internal capital market. As he notes:

> . . . it is true that Japan's credit-based financial system has bestowed formidable powers on the state vis-a-vis the private sector, [but] these powers have waned progressively as Japan's capital markets have developed and as its financial system has become internationalised. (Okimoto 1989: 143.)

Okimoto is willing to subscribe to the notion that Japan is a 'network state'. Despite this, he is keen to emphasise that:

> One of the great myths enshrouding Japanese industrial policy is that it has been error-free and costless. Nothing could be further from the truth. One need not look far to find pockets of conspicuous inefficiency in the Japanese economy. (Okimoto, 1988: 223.)

Samuels (1987) provides a stronger critique of the statist interpretation of Japanese economic success. His point is that there is a tendency in this interpretation to treat the policy-making process in a mechanical fashion, with the private sector responding passively to bureaucratic initiative and guidance. Samuels suggests that a better characterisation of the complex dynamics of the policy-making process in Japan is the 'politics of reciprocal consent', where a fragmented state authority (caused, for example, by inter- and intra-bureaucracy rivalry) negotiates with a powerful private sector. This nuanced portrait of the policy-making process strongly implies that consensus building is often a matter of negotiation and compromise, carrying with it the significant risk that policy-making goals may, during the process of implementation, significantly deviate from their original objectives. Indeed, Samuels maintains that in his study of 70 cases of state intervention in the energy sector he could not find a single clear-cut case where relative state autonomy (that is, the capacity of the state to formulate policies that are not compromised by responding to special interest groups) could be established.

Rosenbluth's (1989) study of the politics of finance in Japan is yet another example of the emerging post-statist current. Her empirical investigation of recent financial deregulation and the internationalisation of the financial sector suggests that the Japanese government—in the form of the Ministry of Finance—was not the prime mover. Instead, her central argument is that:

> Financial regulation is changing in Japan not because the Ministry of Finance . . . now deems that Japanese financial institutions are ready to compete globally, but because the institutions themselves find much of the protective regulation no longer useful. (Rosenbluth 1989: 1.)

The contributions reviewed so far have the specific agenda of highlighting the limitations of the statist interpretation of Japanese economic success. It is intriguing to note that none of the authors seem to be aware that the implications of their analyses also reinforce the basic tenets of neoclassical political economy.

This is particularly evident in the case of Friedman (1988: 3), who proceeds with the ambitious agenda of exposing the limits of both the statist paradigm (labelled the 'bureaucratic regulation hypothesis') and the neoclassical interpretation of Japanese political economy (described as the 'market regulation hypothesis'). Claiming that Japan is a 'misunderstood miracle', he rejects the view that the bureaucrats played a central role in shaping Japanese industry in line with state-determined objectives. Based on his study of the machine tools industry—one of the champions of the international marketplace—Friedman makes the novel point that the Japanese government completely misunderstood the source of the nation's international competitive advantage in that industry. The industry was led by innovation-oriented *small and medium-sized* firms. The bureaucrats, however, felt that the industry needed consolidation into larger units in order to achieve economies of scale. Friedman's study of prewar and postwar policy interventions in the machine tools industry shows that the government failed to consolidate the industry, largely because of private sector resistance. His conclusions carry the startling implication that had the bureaucrats been successful in carrying out their program of consolidation, Japan would have ended up with a loser rather than a winner in international competition!

It would be fair to maintain that, while Friedman offers a devastating critique of statist political economy, he in fact ends up offering an interpretation of Japanese political economy that would be a source of delight to even the most strident neoclassical economist. Friedman seems to be unaware of this irony.

In sum, seen through the eyes of a neoclassical political economist, the post-statist current in the political science literature on Japanese industry policy appears to provide unexpected intellectual ammunition against statist political economy. This literature highlights the fundamental point that even the developmental state may not have a systematic informational advantage over the private sector, and that the latter has the capacity to undermine bureaucratic regulation if such regulation is not in its interest.

CONCLUSION

This chapter has reviewed two alternative paradigms in the political economy of economic development, particularly as they pertain to current debates on the efficacy of strategic trade policy in Northeast Asia. The chapter has provided a 'first principles' review of the substantive issues. It has delineated the key features of both neoclassical and statist political economy. It has suggested that neoclassical political economy is a broad-based theory, despite the strident versions of some writers working in this analytical tradition. Neoclassical political economy, appropriately interpreted, is eclectic with respect to the relative significance of market failure and government failure. Thus the key policy and political challenge is to design institutional arrangements that can minimise both market and government failure.

The chapter has also attempted an interpretation of statist political economy in terms of a particular analytical framework, namely the QIO paradigm. Such an approach may seem unduly selective, but it has been argued that the approach is flexible enough to accommodate nuances in the statist literature.

It seems that some statist writers make the point that Northeast Asian–style political management accompanied the implementation of neoclassical policies. Others make the stronger point that the aggressive pursuit of strategic trade policy or, more broadly, sector-specific interventionism is the essence of successful economic management in Northeast Asia. The chapter has argued that such an interpretation is undermined by a number of significant analytical deficiencies. This conclusion was reinforced by drawing on a selected sample of studies of Japanese political economy undertaken by political scientists.

In highlighting the works of political scientists on Japan, I have suggested that, although this literature does not arise from the neoclassical tradition, its implications apparently provide unconscious support for the neoclassical position. This should not be construed as an exercise in point-scoring across disciplinary frontiers. The material presented in this chapter can serve as the basis for broader and more profound messages. First, the Japanese experience implies that states with more modest policy-making capacities are likely to face insurmountable difficulties in implementing strategic trade policy. This in turn leads to the point that neoclassical principles of governance (confining public action to specific areas, parametric intervention to deal with proven cases of market failure, and so forth) are highly pertinent to both developmental and non-developmental states. Finally, there should be further explorations of undetected links between the political science literature on the political economy of development and the neoclassical position. Such explorations may well provide the basis for a new research paradigm in which the productive interface between politics and economics can serve to illuminate, rather than obfuscate, the underlying sources of economic success in Northeast Asia and elsewhere.

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4 The Realignment of Business–Government Relations and Regime Transition in Taiwan

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During the 1980s, relations between business and government in Taiwan were substantially restructured, with business interests coming to exert a much greater degree of influence over economic policy. A number of factors lay behind the change. The most conspicuous were the dramatic shifts in Taiwan's political system as entrenched authoritarian rule gave way to pressures for democratisation. A realignment of power relativities among state institutions, a shift in the sources of power of sections of the state elite, and the emergence of splintering and factionalism among party leaders over the issue of political succession all served to create strategic openings that could be exploited by an expanding private business elite seeking to secure greater influence in the policy process. An added incentive for business groups in this respect was that the processes of democratisation also enabled less economically advantaged sectors of society to mobilise and advance their demands. In the face of calls for a shift in Taiwan's developmental priorities and greater emphasis on redistributive measures, the business elite had to take active political measures to protect its basic interests.

In addition to domestic political factors such as these, there were other forces contributing to the changing relationship between business and the state. Shifts in the dynamics of the global economy and mounting trade pressure from the United States pushed Taiwan towards major structural adjustment. Related to this was the international prevalence of liberal economic ideas about the appropriate economic functions of government. Inevitably, moves to retrench interventionist economic policies and allow market forces to play a greater role entailed the transfer of greater economic sovereignty to the private sector.

The extent of the change should not, however, be exaggerated. The shifts in the pattern of relations between business and the state were adaptive and evolutionary, rather than revolutionary. Established institutional arrangements and ideological traditions could not be easily overturned. To steer the national economy through unfamiliar economic and political terrain, the incumbent elite relied on the existing repertoire of policy instruments. In short, important though the recent changes have been, viewed from the perspective of the early 1990s, elements of continuity still outweigh elements of discontinuity. For an adequate understanding of the emerging changes in business–state relations we must situate the developments of the 1980s in a broader historical and institutional framework. To this end, the chapter begins by outlining the pre-existing patterns of state–business interaction, highlighting their structural, institutional and ideological foundations. Next, it presents a detailed account of the changes taking place in various aspects of the state–business relationship and an empirically informed analysis of underlying causes. This is followed by an assessment of the implications of the resulting patterns of state–business policy consultation, interest intermediation and bargaining over development strategy, and the workings of the emerging political system.

Before proceeding to these substantive issues, a short comment on methodology is needed. Analytically, the focus of this study is at the national level. It is my view that the national level provides a better vantage point than the sectoral level for a systematic understanding of state–business relations in Taiwan. A number of key institutional arrangements and structural characteristics of the state and political regime which shape the overall policy-making process cannot be reduced to sector-level analysis. More importantly, on many accounts, sectors (defined as clusters of firms producing or providing functionally identical products or services) may not be the most meaningful unit of political analysis in Taiwan, where family-owned enterprises (especially the diversified business groups), region-based local factions, party-sanctioned elite business clubs, and policy-related clusters of business interests are of equal if not greater analytical significance. In most cases these latter groupings (which frequently are not coterminous with sectoral boundaries) are where common political interests are conceived, collective action strategies planned, organisational resource pools accumulated and interlocking social networks developed. In Taiwan, patterns of segmentation and aggregation within the business community arise more from state institutions and state policies than from common economic characteristics. As a result, the starting point for a satisfactory analysis of past patterns of state–

business relations must be the overarching authoritarian structure which produced the institutional cleavage between the Kuomintang (KMT) national leadership and the business community, and delimited the wider political setting in which state–business relationships evolved. And it is to this that we now turn.

BUSINESS–GOVERNMENT INTERACTION DURING THE AUTHORITARIAN YEARS

During the period of one-party authoritarian rule, the KMT relied on a proven formula for maintaining the entrenched political dominance of the mainlander elite (the emigré group that fled to the island after being defeated by the Chinese communists in 1949) at the national level, and for controlling a limited popular electoral process at the local level. Formally, the KMT state maintained a complicated five-branch (Yuan) national government, with a functioning legislature claiming to represent all the provinces of China with its life-term members elected in 1948 on the mainland. Limited home rule was implemented in 1950 under which the native Taiwanese population—also ethnically Chinese and who migrated to the island during the 18th and 19th centuries—were allowed to elect their representatives up to the provincial level and executive heads up to the county/city level (Tien 1989).

Another important feature of the political structure was the fusion of the party and the state (Chu 1992). The party provided the only formal links and coordinating mechanism among disparate arms of the state. The institutionalisation of the paramount leader in the party power structure laid the foundation for the autonomy and coherence of the party-state. All major government appointments and decisions and all proposed legislation had to be approved by the central decision-making body of the party. The party also established a system of elite recruitment and selective incorporation, enabling it to exercise partisan control over the appointment and promotion of middle- to high-ranking government officials and military officers. No branch of the state apparatus, not even the judiciary, was immune from penetration by the party organisation or the influence of party bureaucrats. For almost four decades no new party was allowed to form and compete with the KMT.

The party apparatus consisted of cross-cutting functional units organised along both regional and sectorial lines. At the grass roots level, the KMT utilised existing patron–client networks to establish a complex local political machine within the party structure across the island. In each administrative district below the provincial government, the KMT nurtured and kept at least two competing local factions striving for public office (Winckler 1981; Chen & Chu 1992). Above the local level, the KMT controlled and demobilised all modern social sectors through pre-emptive incorporation of business and professional associations, labour unions, state employees, journalists, intellectuals, women, students and other targeted groups. The party permeated almost all aspects of political life, with membership reaching almost 20 per cent of the entire adult male population (Winckler 1984: 481–99; Jiang and Wu 1992). Through its exclusive control over the major agents of socialisation—schools and mass media—the mainlander elite constructed an ideologically indoctrinated population (Gold 1986). Finally, wherever indoctrination or co-optation failed, the security apparatus stepped in. Under martial law, the security agencies were quick to suppress even a hint of political dissidence.

For almost three decades, the KMT faced a very unorganised and weak political opposition consisting primarily of defiant local factions which harboured no national political ambitions.[1] Thus, for an extended period, the ruling elite was under little or no pressure from even limited electoral competition at the national level. It was only in the wake of the loss of the UN seat to the People's Republic of China in the early 1970s—and the resulting diplomatic derecognition by major allies which severely undermined the KMT's claim to be the sole legitimate government of all China—that the KMT elite began to feel the need to strengthen the legitimating function of elective institutions. As a result, limited electoral openings in national representative bodies were initiated in 1972 and later expanded in 1980 (Hu & Chu 1992: 178–81).

In order to secure the allegiance of key business groups, the party leadership strategically allocated entry rights to lucrative oligopoly arrangements. At the national level, these rent-taking opportunities were allocated to state-owned enterprises under the Veterans Affairs Commission and other semi-public (parastatal) corporations which employed large numbers of loyalist mainlanders; to party-owned enterprises; to a few politically well-connected mainlander firms; and to prominent Taiwanese families. The price of these benefits was political cooperation and loyalty (Chu 1989b). The industries affected by these arrangements were scattered across the manufacturing and services sectors and included cement, paper, tyres, glass, special chemicals, pharmaceuticals, telecommunications equipment, investment trusts, brokerage, insurance, leasing, shipping, airlines and mass media (Chu 1989b; Chen & Chang 1991). At the local level, the economic rents created by local government procurement and regulation accrued to the local factions, which typically held an economic stake in region-based oligopolies such as public transportation, credit unions, farm produce cartels, construction, public utilities and certain illicit economic activities, (Chu 1989b; Chen & Chu 1992). These national and regional oligopolistic arrangements provided tangible bases for the KMT to co-opt the native economic and political elite.

Within the larger institutional framework, the business elite was on the fringe of the KMT power structure. To begin with, ethnicity was an important barrier, with the mainlander party-state elite being sharply differentiated from the Taiwanese business elite.[2] The two communities had little in common and lacked lineage bonds, marital ties or shared social backgrounds. As a result of this sub-ethnic division, the state was relatively unconstrained by the personal or family loyalties between officials and business people which feature so prominently in many Southeast Asian countries. In addition to this social division there were formidable institutional cleavages between the party's national leadership and the private business community. In the party's formal power structure the business community as a whole had very limited representation.[3] Not only did business interests have little direct representation, the scope for vicarious representation by bureaucrats was also limited. For the private sector, the Ministry of Economic Affairs (MEA) was the major conduit for government–business policy consultation. However, in the highest echelons of the party-state apparatus senior economic officials did not enjoy the same political standing as their counterparts in the military, security and foreign policy agencies or senior party officials in charge of organisational and ideological affairs. A wide range of public policies—defence, foreign affairs, education, culture and even monetary policy (Chu 1987b)—were off-limits to the economic technocrats at MEA and the Council for Economic Development and Planning.

Economic officials were not entrusted with the power to dispense firm-specific economic privileges. Politically sensitive economic decisions of this sort required consultation with party leaders. Nonetheless, the economic technocrats enjoyed a high degree of autonomy from business and other societal interests, because they were answerable only to the party's top leadership and were responsible mainly for overall economic performance and the success of certain targeted sectors. They were not answerable to the national representative bodies and their political fortunes relied little on maintaining a rapport with the business community. Economic technocrats approached business–government liaison with caution, and seldom went beyond the prescribed institutional channels. In part this reflected their tendency to view with disdain criticism of government policy. A further factor, however, was that their actions were subject to surveillance by security agencies and party officials. Leniency toward private economic actors could be mistaken for favouritism.

The autonomy of the economic technocrats was further buttressed by their direct control of an economic base independent of the private sector: the entire banking sector and a vast array of state-owned enterprises. The state-owned enterprises had a monopoly or near-monopoly in a large number of manufacturing sectors—energy, public utilities, fertiliser, sugar refining, tobacco and wine, steel, shipbuilding, heavy machinery, construction and defence-related industries (Wade 1990: 272–5; Chen & Chang 1991: 29–61). The span of state ownership also extended to many service-based sectors, including public transportation, shipping, insurance and financial services. In most of these sectors state ownership precluded private participation. Although the significance of the state-owned enterprises in the overall economy declined steadily in the face of higher private sector growth rates during the 1960s and 1970s, they still constituted a preponderant economic power. For most of the 1970s total investment in the state-enterprise sector accounted for more than a third of gross domestic fixed capital formation (Chu 1987b). The combined asset value of the state-enterprise sector was continuously several times bigger than that of Taiwan's top 500 private companies up until the late 1980s (Chen & Chang 1991).

State-owned enterprises served a number of economic and political functions. They gave the state direct control over strategic materials, facilitated industrial upgrading, aided the implementation of anti-cyclical policies and supply-side management, and guaranteed economic security for the loyal mainlander followers (Cheng & Haggard 1987; Chu 1989a). They also provided a self-sufficient training base for the state economic bureaucracy to develop managerial and planning expertise. Numerous elite planning technocrats emerged from the managerial stratum of state-owned enterprises and ultimately retired to the boardrooms of the same enterprises. Most importantly of all, state-owned enterprises provided the technocratic elite with the economic resources to build an array of satellite suppliers and downstream firms around state enterprises, which in turn effectively served as extended arms of the bureaucracy.

The formal channels for communication between government officials and private sector business leaders were the numerous state-sponsored industrial associations. This hierarchical system of business associations was clearly designed along corporatist lines, with each constituent industrial association being a singular, compulsory, non-competitive, state-sponsored organisation enjoying exclusive representation and being endowed with specified regulatory authority

(Schmitter 1974; Wade 1990). Within this hierarchical system meso-level encompassing organisations were created to represent a wide spectrum of business concerns. At the top of the hierarchy were three national peak organisations—the Federation of Industry and the Federation of Commerce, representing the entire manufacturing and service sectors respectively, and the blue-ribbon National Council of Industry and Commerce (NCIC) whose membership included virtually all elite business groups. The NCIC was the foremost national business association because of both its membership and its many state-sanctioned prerogatives. The NCIC enjoyed exclusive representation in all non-governmental international organisations, such as the Pacific Business and Economic Council and the Pacific Economic Cooperation Council. The NCIC was also the sole conduit for bilateral exchanges between national business organisations. A weekly breakfast meeting held under the auspices of the NCIC became (and still is) the most important institutionalised channel of communication between business leaders and government officials.

This network of industrial associations was designed to function as an arm of both the state economic bureaucracy and the KMT. Bureaucrats at the Industrial Development Bureau (under the Ministry of Economic Affairs) used the constituent industrial associations to conduct industrial surveys, collect and disseminate business information, solicit policy inputs, and implement government policy initiatives such as orderly market agreements and export quotas (Wade 1990: 280–2). The KMT used these associations to penetrate, organise and demobilise various segments of society. Elections for leadership positions in business associations were conducted under the guidance of the KMT's Social Affairs Department. The leaders of the national peak organisations were usually handpicked by the paramount party leader, Chiang Ching-kuo. Leadership positions were keenly sought after, not just for prestige and recognition but also, importantly, for the opportunity they provided to develop intimate personal ties with high-ranking economic and party officials. Thus behind the veil of corporatist arrangements in the business sector was a complex web of clientelistic relationships which provided the party-state elite with a mechanism of intimate control and selected co-optation.

At the top of this clientelistic network was a small number of privileged business leaders who had developed close personal ties with members of the party central leadership—typically through marital ties (*Business Weekly*, Taipei, 6 October 1991: 64–8). They virtually monopolised access to party leaders and retained their strategic posts as long as their political loyalty remained unquestioned. The most conspicuous example is the Koo family. J. F. Koo, heir to the most prominent Taiwanese family that cooperated faithfully with the Kuomintang during the period of regime consolidation, has been the chairman of the NCIC since 1958 and a member of the KMT central committee since 1981. The family's business empire is concentrated in the state-harboured oligopolistic sectors and is the second-largest corporate grouping in Taiwan.[4]

Many of these state-sanctioned business associations could have become an institutional base for organising autonomous collective action among private business interests, but, although some of them eventually did, most did not during the authoritarian years. This was due not only to the determinedly authoritarian nature of the regime, but also to some of the structural characteristics of the private sector. Most of the export-oriented sectors—where the bulk of the private national firms were concentrated—consisted of a large number of small and medium-sized firms which typically lacked the necessary resources and skills for organising group-based action.[5] In these sectors, both entry barriers and exit costs were quite low: firms moved in and out of a given sector with ease. These conditions encouraged private adjustment instead of collective bargaining and invited the so-called 'free-rider' phenomenon so detrimental to effective collective action (Olson 1965; Shafer 1990).

Even in sectors where a limited number of national private firms dominated, the owners of the leading firms still refrained from organising sector-based collective action outside the state-prescribed perimeters—for good reasons. First, most of these leading firms belonged to a diversified family-owned business group. Sector-based group action would inevitably benefit their rivals in the industry as well as their subsidiaries. On the other hand, the return from investing in personalised ties with high-ranking state officials or from cultivating political affiliation with the national party leadership was much higher, as the relationship generated exclusive benefits for the sibling firms in the family-owned group. Moreover, such benefits were likely to be enduring as both the business people and the officials concerned were likely to stay on for a long time. Second, because of the weakness of their political position most large business groups tended to avoid behaviour that might damage their working relationship with the responsible state agencies. The fortunes of large firms depended on the goodwill of government much more than did those of small and medium-sized firms. This was because economic officials administered powerful policy instruments—bank credits, protectionist measures, fiscal incentives and market-order regulations—with a certain degree of selectivity among large scale firms. Large firms enjoying preferential treatment were most unlikely to jeopardise it by undertaking political action of which officials would disapprove.

To summarise, from the 1950s through the 1970s business did not assert itself as an autonomous and organised political actor in the policy-making process, nor were its interests well represented in the party power structure. The KMT-directed political structure encouraged business people to seek individual ties rather than attempt group-based coalitional politics. A range of factors contributed to this unequal, top-down political relationship between the party-state and the private sector. On the one hand, the decentralised industrial structure of much of the private sector, together with the dependence of the large conglomerates on state assistance, reduced the likelihood of effective collective action developing. On the other hand, the party-state's leverage was enhanced by a number of organisational factors: political authority was highly centralised; there was a large and capable military and administrative apparatus along with a wide array of state-owned enterprises; and the party-state controlled the corporatist framework around which business representation was structured. Finally, the support of the business community was not crucial to the regime's survival, as its claims to legitimacy were based on international diplomatic recognition guaranteeing military security and delivering economic prosperity. None of these required fully fledged political recognition of the private sector.

THE IMPETUS FOR CHANGE

During the 1980s, important changes in the nature of relations between business and government began to emerge. Beginning in the mid-80s, Taiwan's trade and financial regimes underwent extensive liberalisation. Although the impetus for change came from the United States rather than the local private sector, one of the consequences was to shift the underlying state–business power balance in favour of business. Put simply, the capacity of the economic bureaucracy to steer the economy was eroded markedly.

The immediate catalyst for change was the rise of neo-protectionism in the developed countries as multilateralism was replaced by growing bilateralism and demands for specific trade reciprocity. The US government was particularly keen to strike down the protectionist wall of tariff and non-tariff trade barriers and to remove what it saw as unfair trade practices. As a result of this external pressure many of Taiwan's long-established trade policies—mandatory export-ratio requirements, domestic content requirements and export subsidies—were gradually phased out. In the second half of the 1980s, Taiwan's stringent regulations on foreign exchange came under attack as US trade officials learned that exchange rate adjustment could be an even more powerful instrument to wipe out the cost advantage of Taiwanese exporters and to override tariff protection. The Central Bank was forced to ease its curb on currency appreciation, resulting in a huge 48 per cent appreciation of the New Taiwan dollar against the US dollar between 1986 and 1988.

Steep currency appreciation worsened an emerging macroeconomic disequilibrium which had been worrying Taiwan's economic officials since the early 1980s. Domestic private investment declined and the gap between domestic savings and domestic investment steadily widened. At the same time, official foreign reserves continued to pile up and the economy became 'saddled' with cash, creating havoc in stock and real estate markets. In the face of these economic pressures, the government in 1988 was forced to relax foreign exchange regulations further and remove most of the long-running restrictions on capital outflow. In effect, the pent-up reservoir of economic power in the private sector finally overflowed the dam of a *dirigiste* economic regime.

Major change was under way and economic officials had to adapt themselves to a new set of circumstances. The government could no longer maintain barriers between the domestic economy and the international economy, something that had underpinned effective macroeconomic management and sectoral planning (Wade 1987). The private sector gradually moved out of its dependence on the state for orderly market regulations and the supply of essential resources (information, finance, technology, etc.), and began to improve its risk-absorbing capacity. The newly available option of overseas relocation and foreign investment further strengthened the bargaining position of the private sector vis-a-vis the state economic bureaucracy. In short, the private firms became more responsive to market changes and less susceptible to government directives. At the same time, state enterprises—which had been the major vehicle for the development of capital-intensive sectors during the 1970s—came to be seen as increasingly inadequate for managing the complexity of high-tech sectors and the challenges of the late 1980s and 1990s.

Confronted with these various developments the state economic bureaucracy moved to undertake policy and organisational reforms. These changes took two general directions: a refurbishing of the steering capacity of the state; and a broadening of the scope for private sector involvement in the formulation of economic policies. The most important manifestation of this reform drive was the effort to vastly enhance the state's steering capacity in the development of high-tech sectors and in the upgrading of conventional export sectors. To this end, a range of new mechanisms for planning, implementing and evaluating the promotion of technology-intensive sectors were introduced to the bureaucracy. The most conspicuous of these was the creation of a new supra-ministry-level advisory body, the Science and Technology Advisory Group. The Group hired outside experts (foreigners and overseas Chinese) and was responsible for assisting the Cabinet in supervising implementation of the National Science and Technology Program, reviewing R&D project proposals submitted by various state agencies, and generating new initiatives to promote technological development. Equivalent advisory mechanisms were also established in ministry-level agencies throughout the executive branch (Meany 1989). At the level of policy implementation, state research laboratories and parastatal research organisations under the MEA, the Ministry of Communications and Transportation, the Ministry of Defence and the National Science Council were entrusted with the responsibility of assisting the private sector and carrying out research in areas targeted by the Strategic Industries Program. These included microelectronics, telecommunications, bio-medicine, special chemicals, materials science, precision machinery, nuclear energy and aerospace.[6] The fruits of the research were then transferred to qualified private firms or to new semi-public joint ventures for commercialisation.[7]

New parastatal agencies were created and a number of existing state agencies were revamped to support the drive to promote industrial upgrading. The Institute of Information Industries was created in 1979 to spur the application of computer technology in both the public and private sectors (Kao 1989: 75–80). The China Productivity Centre emerged as the training centre for the private sector to acquire factory automation and quality control knowhow. The National Science Council was entrusted with the development and management of the Hsin-Chu Science Park and other science park projects.[8] Foreign investors were invited to the Park with the attraction of easy access to the R&D facilities of parastatal research organisations and major universities, as well as ready financing by the state-owned development bank and semi-public venture capital.

New financial vehicles such as the Executive Yuan Development Fund (a revolving investment fund established in 1982) and a rechartered Industrial Development Bank[9] played an important part in supporting state-sponsored investment projects in strategic industries (Kao 1989: 69). These institutions provided the financial backing for all major commercially oriented projects undertaken by the state research organisations and their subsidiaries and also underwrote a number of state-sponsored buyouts of US high-tech firms, such as Altos and WYSE.

Another novel player that became involved in promoting high-tech industry was the Kuomintang Central Finance Committee (CFC). The CFC participated in almost every major state-sponsored joint venture in the high-tech sectors via its six holding companies (*Fortune News*, Taipei, May 1988). The CFC emerged as a convenient vehicle for the creation of a new commercial entity, a tripartite joint venture linking the state enterprises, the KMT and private firms. These innovative hybrids were technically 'private companies' and thus not subject to legislative oversight or scrutiny by the government auditing agency. However, the combined share of the government and the party in the joint venture was typically larger than 50 per cent, which allowed the economic technocrats and their appointed executives to exercise full control over business operations.

By the end of 1980s, the outcome of the high-tech drive began to take shape. A new policy network had been created, linking planning agencies, state banks, semi-public venture capital, high-tech start-ups, parastatal research organisations, university research centres, foreign consultant firms and the Chinese-American science and engineering community. And, as hoped, a range of sunrise business sectors grew up around the strategic nodes of state-run R&D organisations and finance institutions. For present purposes, however, more important than the success of this coordinated policy drive was the fact that it represented a virtual refurbishment of the power base of the state's economic officials.

Accompanying the drive for industrial upgrading were moves by the state elite to incorporate the private sector into the policy process. The first step in this direction had been taken in the early 1980s. In response to early signs of the slowdown in private sector investment, the government had decided to organize a blue-ribbon Economic Reform Advisory Council aimed at forging a new consensus on national development strategy among business leaders, state officials and academics. At the forum, representatives of both business and academia called for the deregulation of a number of state-dominated sectors (especially the financial sector in which private participation was prohibited) and for the privatisation of certain state enterprises. Although all the proposals were subsequently pigeon-holed by state officials, the exercise did help to place liberal economic ideas on the political agenda for the future. Then, as the 1980s progressed, a number of new institutional channels for policy consultation were established. A notable example was the creation in 1982 of the Industrial Policy Advisory Board, immediately under the Minister of

Economic Affairs. The Advisory Board covered a wide range of major industries and was supported by a semi-public industrial–economic thinktank—the Taiwan Institute for Economic Research. The Strategic Industries Program mentioned above was the first master plan in which private sector inputs were incorporated through the new Advisory Board. In a parallel initiative, a series of specialised policy review panels were created under the Science and Technology Advisory Office of the MEA and the Industrial Development Bank. These advisory panels brought in representatives of industrial associations and civilian scientists to review government-sponsored research projects and appraise new policy proposals.

These developments signalled an important shift in the nature of relations between business and government in Taiwan. For the first time, private sector views were being incorporated in a serious fashion into the formation of economic policy. This reflected growing official recognition of the importance of the private sector. However, at least to begin with, these changes were driven not by direct pressure from business but by deteriorating economic circumstances. Moreover, senior economic officials did not loosen their control over agenda-setting. They initiated most of the organisational adjustments and policy redirections discussed above, and had the final say in the allocation of development funds and R&D budgets. And while business did indeed acquire a real voice in policy deliberations, the benefit varied and was dependent upon the preparedness of particular ministers to receive external advice.[10]

THE RISE OF BUSINESS INFLUENCE

By the end of the 1980s it was apparent that the political influence of the business elite was increasing markedly. With the death in 1988 of the paramount party leader, Chiang Ching-kuo, the cohesion of the party central leadership deteriorated and the pace of democratisation speeded up. Personnel turnover, splits within the state and the development of new democratic institutions provided the business community with an unprecedented strategic opening.

The expansion of electoral politics and growing importance of the parliament provided the business elite with new opportunities to pursue influence-buying. Structured corruption which had long been fermenting in local electoral politics was rapidly transmitted to the national electoral arena. It was based on a multi-member district SNTV electoral system[11] and personal-voting strategies (Rosenbluth 1992: 3–4) involving particularistic constituency services, candidate-based election financing and institutionalised vote-buying mechanisms (including outright bribery)[12] in order to build support networks for candidates (Bosco 1992). The plain implication of the rapid expansion of these practices was that for most candidates the road to electoral success was paved with gold bricks.[13] Large corporations suddenly became the most sought-after patrons of politicians and the local support factions. Although politically attractive for many business leaders, such opportunities for influence-buying did not come cheaply: donors had to support not just the political candidates themselves but also their extensive—and thus costly—factions or networks of personal support.[14]

As elected politicians came to dominate the Legislative Yuan (replacing the ageing life-long members), competition for lucrative committee roles (such as Budget, Finance and Economics) and secure sources of political funding became intense. In the 1989 election, most of the support from business groups was directed to KMT and independent candidates. Senior KMT officials responsible for managing the party nomination process encouraged this pattern of structured corruption and even provided a legal shield for illicit vote-buying practices, as this seemed a sure way to contain the electoral growth of the opposition candidates. It was estimated that in the Legislative Yuan of 1989–1992, 38 of the 101 popularly elected members had *publicly known* ties with at least one business group, with many of them also holding positions as company directors and receiving free company cars, chauffeurs and secretaries (*Business Weekly*, Taipei, 22 September 1991: 52–7). Established business groups that had succeeded in building up clientelistic networks with bureaucratic and party leaders over the years had a less pressing interest in cultivating parliamentary allies. Conversely, new and less well-established firms were typically the most enthusiastic sponsors of elected politicians. Business groups with a definite regional base also invested heavily in the election of the county magistrates and city mayors. Of the twenty-four magistrates and mayors elected in 1989, eighteen received financial backing from one business group or another (Chang 1990: 42).

These developments have coincided with the breaking down of barriers separating and insulating the central leadership of the party-state from the business community. One factor here was that as the trend towards indigenisation within the party-state accelerated, the scope for preferential access by business leaders on the basis of interpersonal or family ties increased. More important than this, however, was the fact that factional schisms generated by the struggle for succession following Chiang Ching-kuo's death compelled competing power blocs within the party central leadership to bring in new allies from outside the party. The obvious candidates on the basis of both access to finance and ideological compatibility were business groups.

The so-called 'mainstream faction' in the party reached out to the business community much more vigorously as it at first had a weaker power base within the party-state. This power bloc centred on President Lee Tung-hui, a Taiwanese technocrat handpicked by Chiang Ching-kuo as his successor. The opponents of Lee Tung-hui circled around Premier Hau Bo-tsun, a former defence minister with a strong power base in the military and security apparatus. In a race to build a broad-based constituency within the business community, party leaders and government officials in both camps became increasingly ready to listen sympathically to business grievances.

More broadly, in the late 1980s the party leadership moved to incorporate a wider cross-section of the business elite within its power structures. The past practice of selectively incorporating particular business leaders was phased out and a more inclusive approach adopted under which second-generation business leaders, especially the heirs to the leading conglomerates, were systematically brought within the party fold. In 1989 young business executives were, for the first time, recruited by the Kuomintang to attend a party-run month-long training session (the Seminar on National Construction Planning) at the party's cadre academy. Between 1989 and 1991, more than three hundred business executives became alumni of the seminar. With the encouragement of the party, the alumni organised themselves into four regional alumni associations which were later consolidated into a nation-wide elite business club, the Industry and Business Construction Planning Council. The Council and its regional chapters provided another important channel for government–business contacts. An indication of the economic significance of this elite business association is that the total turnover of the companies represented amounted to 40 per cent of Taiwan's GDP.[15]

The increasing influence of business within the parliament and the KMT contributed to a shift in the prevailing policy outlook in the economic ministries as *dirigiste* thinking came to be replaced by a more liberal and pro-business view. Officials who failed to adapt to the new political climate placed their careers at risk.[16] Between 1988 and 1991 there was a strong liberal economic drive, with more deregulatory initiatives implemented than over the whole of the two preceding decades. Prominent among them were the removal of entry barriers to industries dominated by state or parastatal enterprises (such as commercial banking, investment banking, construction, mass transportation, airlines and midstream petrochemicals); the earmarking of many state enterprises for privatisation; and the opening of industries with state-harboured oligopolies (such as security brokerage, newspapers and insurance) to new entrants.

These changes were not confined to the economic ministries alone; even the secretive Ministry of Defence modified its policy on military procurements. The bidding process for military contracts became more open, and private participation in the production of military equipment broadened. Similarly, the military-controlled Sun Yat-sen Science Institute joined hands with the private sector for the commercialisation of selected items of defence-related technology. In short, the military establishment sought to secure its interests by building up a small scale military–industrial complex in the private economy.

IMPLICATIONS FOR THE BUREAUCRACY AND THE PARTY

The growing political importance of the business elite on one hand and the parliament on the other has eroded the autonomy of the state economic bureaucracy. The Legislative Yuan has become an arena for horse-trading among economic officials, party officials and lawmakers who act as surrogates of special business interests. One immediate consequence of the politicisation of economic decision making has been that the Cabinet can no longer force its way through the Legislative Yuan; economic officials must make compromises over the content of legislative proposals and the timetable for their implementation. Individual lawmakers can wield considerable influence in the law-making process. A standing committee typically has only a dozen members, which means that a handful of resolute legislators can amend or block government legislative proposals at the committee stage.

As the parliament has moved rapidly to join the party and the Cabinet at the centre of the political stage, the KMT has been forced to search for new policy coordination mechanisms. To this end, an ad hoc six-member coordination committee consisting of the premier, the secretary-general of the Executive Yuan, the secretary-general of the KMT central secretariat, the chair of the KMT policy coordination committee, the Speaker of the Legislative Yuan and the party whip of the parliament was established to resolve major disputes. However, the authority of this ad hoc committee has often been questioned by maverick lawmakers, and the compromise agreements it produces are not always enforceable in the Legislative Yuan. While the party secretariat is still able to impose discipline on KMT lawmakers over politically sensitive issues, on economic and financial matters the lawmakers have often gone their own way. On some occasions defiant pro-business KMT lawmakers have joined with the opposition, which controls less than 28 per cent of seats in the legislature and is critical of any government proposal to expand the state's direct involvement in the economy. This is not a firm alliance, however, for on other occasions the opposition may join with KMT members elected from the metropolitan constituency—the only area where the influence of vote-buying and factionalism is tenuous—to protect the interests of average white-collar families.

In recent years, economic officials have run into tough legislative battles over important economic and financial legislation. The most strenuous opposition has come from entrenched business interests created by past market-restricting policies. For instance, as part of the government's import liberalisation drive the annual adjustment of the tariff table inevitably draws strong resistance from the industries affected. Economic officials find themselves sandwiched between the opposing demands of lawmakers representing importers and domestic manufacturers respectively. A deep tariff cut in one category of products is often followed by a freeze the next year as the losing side regroups and redoubles its political effort.[17] This pattern has been replicated across other areas of economic policy. For instance, when the Ministry of Finance sought to strengthen a security transaction tax in a bid to cool the overheated stock exchange, it encountered fierce opposition from the parliamentary representatives of the brokerage firms. After initially proposing a 400 per cent increase in the transaction tax, thereby raising the rate from 0.3 per cent to a hefty 1.5 per cent, the Ministry finally agreed to a compromise 0.6 per cent following intervention and mediation by the party's central secretariat.

The growing influence of business groups and the parliament has also inflicted a toll upon the state-owned enterprises. State-owned enterprises are no longer able to expand into new lines of business at the cost of the private sector. A KMT lawmaker, who served on the board of directors of the largest private steel company, virtually single-handedly blocked an investment plan of the state-owned China Steel to move into a specialised steel market. In another case, the plan of a foreign joint venture of China Steel to build a US$2.9 billion plant in Malaysia was subject to indefinite delay following a veto by the Legislative Yuan. Some legislators baulked at the plan, in part because Taiwan's small private steel firms objected to their state-run competitor tapping public funds to gain strength overseas (*FEER*, 6 February 1992: 37–8). In the light of developments of this sort, many state-owned enterprises have learned to 'bribe' lawmakers to protect their budgets and operational autonomy by awarding them sweet business deals.[18]

The increasing leverage of business in the economic policy-making process has meant that, for most sector-specific economic measures, the bureaucracy now has to take into account possible private sector reaction, especially in the case of the giant business groups, and prepare itself for compromise. However, the influence of the special business interests on economic policy making should not be overstated. On balance, the economic bureaucracy is still the steering force behind most economic reforms. Many of the deregulatory reforms adopted in recent years should not be viewed simply as policy concessions to the private sector. The reality is more complex. In most cases policy redirections were adopted because, to begin with, they had strong advocates in the economic bureaucracy and in academia. In line with the prevailing international currents in economic thinking in the 1980s, liberal economic ideas were increasingly taken up by Taiwanese officials. Market-opening reforms were favoured because of the expected benefits to the economy as a whole.

A convenient illustration of the continuing dominance of officials in the policy process is the deregulation of the banking sector—one of the most far-reaching liberal reforms of recent years. The draft Banking Law prepared by the Ministry of Finance was designed to regulate the number of new banks and to diversify their ownership. The minimum capital requirement was set at NT$10 billion (US$400 million). The share of a single corporate investor was limited to 5 per cent, with that of a diversified business group limited to 15 per cent (Wei 1991). The only major concession made to lawmakers in the final version of the bill was a 50 per cent reduction in the minimum capital requirement. The figure originally proposed, NT$20 billion, was extraordinarily high by international standards and seems likely to have been viewed by economic officials only as a bargaining device. Other comparable major reform packages successfully promoted by the economic bureaucracy in the late 1980s and early 1990s include the Fair Trade Law, the State Enterprise Privatisation Statute, the Industrial Upgrading Statute, and the Small and Medium-sized Enterprise Development Statute.

Broad-ranging economic policy issues are still largely controlled by the executive branch. An important reason for this is that, notwithstanding the political gains made by the business community, organisationally it remains weak. The business elite still craves particularistic ties and proprietary returns from political investment, and shuns the task of building the permanent organisational base and impersonal links necessary for broad-based collective action. As a result, the business community is far from being a cohesive entity in either organisational or ideological terms. And when sections of business do come together to resist the adverse effects of a new policy it has often been too late.[19] The business community also lacks independent intellectual establishments that can scrutinise government proposals, initiate new policy proposals or counter-proposals, and serve as policy advocate on behalf of the private sector.[20] Business executives do not always fully perceive the multifaceted impact of a particular policy proposal or predict accurately the consequences of alternative arrangements.[21] In contrast, all existing economic thinktanks, notably the Chung-hua Institute for Economic Research and the Taiwan Institute of Economic Research, were created with substantial government endowments and are dependent on government research grants. Many leading economists have been retained by various state agencies and on countless government advisory committees and review panels as equals with business leaders.

Economic officials can also employ a number of political strategies to deal with opposition from the private sector. First, they are able to play upon divisions within the private sector. In a political contest over a particular policy proposal business interests may neutralise each other as the net impact of the proposed policy on different industry groups is weighed up. By placing such political bickering among special interests in the public limelight, officials can mobilise the support of public opinion. Similarly, officials have learned to raise their 'opening bid' in policy debates high enough to have a range of acceptable fallback positions. Foreign pressures can also be used as a powerful lever to break up the entrenched business interests clustered around protectionist regulations. Finally, as a last resort, the government can instruct the law-enforcement agencies to initiate 'tax auditing' measures against particularly recalcitrant firms. The prospect of a rigorous examination by the Bureau of Investigation is unwelcome even to firms that employ orthodox accounting principles.

Broad parallels can be drawn with the shifting political balance between the executive and the legislature. Conspicuous though the growing importance of the parliament has been, the executive branch still holds the upper hand in most cases. There are several reasons for this. First, the executive branch exercises wide-ranging discretionary authority over the dispensation of selective material benefits that porkbarrelling lawmakers crave. Most KMT lawmakers seek extra-legal economic prerogatives, such as exclusive rights in filling government procurement orders and obtaining public works contracts, participation in joint ventures with state enterprises, concessionary loans from state-owned banks, purchase of public land at below-market prices, and classified information for insider trading (Wang 1991). All such prerogatives require a smooth under-the-table working relationship with the relevant state agency. In addition, government officials can be confident of cooperation on major legislative matters from the sizeable number of lawmakers who receive special electoral support from state employees and military personnel. As a last resort, economic officials will take their case to the premier or the President and seek their personal support on key economic proposals. This is usually decisive as, under the existing institutional arrangements, the party leadership still has a final say over party nominations and no individual legislator is politically indispensable.

The autonomy of the economic bureaucracy ultimately rests upon the autonomy of the party's top leadership. To date, the political ascent of the business elite has not reached the point of meaningful leverage over the top party leadership. While their financial leverage does now enable business interests to capture individual lawmakers or even an entire local faction, the party leadership remains beyond their reach. A crucial reason for this is that the KMT enjoys financial independence on a scale unheard of in any other representative democracy (*Fortune News*, Taipei, May 1988; Chen & Chang 1991). Through its Central Finance Committee (CFC), the party has either direct ownership or indirect investment in at least 66 companies, including nine companies listed on the Taiwan Stock Exchange and 27 public companies. The KMT's business empire generates more than NT$4 billion in dividends a year (*Fortune News*, December 1991). This stalwart financial foundation allows the party to run a huge administrative apparatus with 4000 full-time staff on its payroll.

Over the years, the CFC has used its six holding companies to build up a complex web of financial services in areas such as insurance, leasing, retail banking, merchant banking, investment banking, brokerage, investment trusts, venture capital, financial consultancy and real estate. Since 1989, despite harsh criticism from the opposition, the CFC has launched an aggressive expansion plan under the chairmanship of Hsu Li-teh, a former minister of economic affairs. More than twenty new companies were created between 1989 and 1991. To position itself to tap the huge public sector expenditure under the Six-Year National Construction Plan, the party has extended its business interests into construction, land development, pollution control and environmental engineering, aerospace and telecommunications (*Business Weekly*, Taipei, 7 May 1991: 26–8). In order to spread risk and reduce resentment from the private sector, the CFC stopped short of acquiring majority control in the new business ventures. Instead, major diversified business groups were invited to form joint ventures. As a result, unlike the Liberal Democratic Party (LDP) in Japan or the Democratic Liberal Party (DLP) in South Korea, the KMT is highly independent of political donations from big businesses. Furthermore, with an array of enterprises directly or indirectly under its supervision, the party leadership has been able to manage the 'revolving door' phenomenon without compromising its own autonomy as these various 'tame' enterprises generate many cushy jobs for retired high-ranking party and government officials. At the same time the CFC-sponsored joint ventures with the private sector have built up a seamless web binding many leading companies into collusive arrangements and large scale irregular business practices which render them potentially vulnerable to government manipulation.[22]

In addition to its financial independence, another element contributing to the enduring autonomy of the KMT leadership is its control over business associations. Only state-sponsored and party-guided business associations are officially recognised and consulted as part of the policy formation process, delegated formal regulatory authority and made eligible for government grants.[23] State regulations govern the operations, membership, by-laws and finance of these associations, and the party exercises considerable influence over their leadership selection and policy agenda.[24] More broadly, notwithstanding the processes of democratisation at work in Taiwan, the KMT's power structure remains largely unchanged. It is still a hierarchically structured constellation of entrenched officials based permanently in the state and party apparatus. As long as there is no alternative regime in sight, the KMT can effectively construct an unequal partnership with the business elite, in which the party-state elite set the limits on influence-buying and policy contestation. An important element in this asymmetrical power relationship is a persistent institutional bias that enables state officials to exercise selectivity in administering policy incentives and enforcing regulations. This, in turn, dampens the business community's confidence in bureaucratic neutrality and administrative universalism, and encourages the quest for particularistic ties and partisan affiliation. This institutional bias helps the KMT retain the loyalty of a large segment of the business elite, and perpetuates a perception that the interests of the business community lie in the continued political dominance of the ruling party. It also discourages coalition-building within the business community; when the business sector does not enjoy the option of shifting its support between competing parties, it is deprived of a vital bargaining power vis-a-vis the state.

The political leverage of the myriad small and medium-sized enterprises is even more limited than that of big business. Most small and medium-sized enterprises are not in a position to take advantage of the new political openings. They lack the resources to sponsor individual candidates, and the geographical basis of the electoral system discourages political mobilisation along sectoral lines. Small and medium-sized enterprises also lack an effective champion within the state; the Small and Medium-sized Enterprise Bureau (within the MEA) is on the periphery of the economic bureaucracy. As a result the policy input of small and medium-sized enterprises is still largely confined to state-sanctioned industrial associations. In cases where their policy preferences collide with those of the government, they would typically seek to circumvent existing regulations on an individual basis rather than initiate collective action. Having said this, it is nevertheless still the case that private adjustment by the countless small and medium-sized firms can sometimes develop an unplanned momentum of its own and snowball into formidable market pressure which, in due course, may leave the state economic bureaucracy with no other option than to modify policy.[25]

To sum up: in examining the autonomy of the state and party leadership vis-a-vis the private sector in economic policy making, it is important to distinguish between (a) the political capacity of the state elite to assert itself over policy priorities and (b) its administrative capacity to control policy outcomes (Ikenberry 1986). The former capacity has been somewhat weakened but remains quite robust, while the latter has been eroded irreversibly.

CONCLUSION: AN EMERGING CONSERVATIVE ALLIANCE

The relationship between business and government in Taiwan has undergone important changes over the last decade. This process of change is certain to continue over the next ten years, with two emerging trends likely to be of particular significance. The first is the formation of enterprise groupings, similar to *keiretsu* in Japan; the second is the development of factionalism in parliament. Both trends are conducive to the further enhancement of business influence and may point to the development of a Japanese-style conservative coalition linking the bureaucracy, the KMT and big business.

The formation of enterprise groupings is an unintended consequence of recent banking reforms which compel existing family-owned business groups to form new business alliances with compatible partner groups. The fifteen newly licensed banks are likely to become strategic nodes for the formation of a new type of institutionalised liaison among family-owned business groups. It is too early to predict whether these enterprise groupings will evolve into closely knit agglomerates through interlocking directorships. If they do, the unprecedented scale which they will thereby attain will make them potent political actors in the future. The policy concerns of the leaders of these enterprise groupings will become much broader in scope and longer term in nature because of their wider ranging business interests. Potentially, at least, state economic planners and party leaders face a major challenge in attempting to harness the economic might and political clout of these new conglomerates.

Another ominous sign for the party-state leadership is the factionalisation of the legislature. In the past, the party has successfully blocked any independent attempts to form island-wide political alliances among local factions, and has pre-empted the development of channels of horizontal liaison in provincial and national representative bodies. The disciplinary authority of the party was built on its capacity to make or break the political fortunes of a faction by throwing its weight behind rival factions or fostering new competitors in the district. However, the recent split within the party leadership has triggered factionalisation among KMT lawmakers. On the retirement of the generation of life-long members, three major voting blocs (among others) emerged—the Wisdom Coalition (also known as the Breakfast Club), the New Kuomintang Alliance and the Parliamentary Reform Association. The Wisdom Coalition and the much smaller New Kuomintang Alliance have become the legislative surrogates of the mainstream and non-mainstream factions respectively, while the Parliamentary Reform Association is believed to lean toward the non-mainstream camp. So far, none of these factions has developed its own organisational networks outside the legislative arena or succeeded in generating a pool of resources for its members. Moreover, individual lawmakers still rely on their local factions rather than parliamentary factions in seeking party nomination and re-election. Nonetheless, these legislative factions (or their successors) have the clear potential to evolve into autonomous power blocs that could assert control over the legislative agenda and make inroads into the Cabinet and the party's central leadership. The likelihood of this coming to pass will increase greatly if the schism within the party leadership deepens or if some of the emerging business conglomerates are willing to make long-term political investments by channelling significant resources to particular factions. Either scenario is quite conceivable.

While policy disputes between the business and political elites in Taiwan are increasingly prominent, they should not be exaggerated.

Underlying such differences is a solid and expanding foundation of shared political interests: both see the need for the involvement of an active state in the process of industrial upgrading; both put economic growth before environmental considerations; both favour a slow growth in social welfare spending; and both support a state-orchestrated exclusion of organised labour from economic policy making. Shared interests of this sort mean that as the old system of authoritarian statism breaks down in Taiwan it is being replaced by a structured partnership between state and capital resembling the Japanese model of 'corporatism without labour' (Pempel 1978, 1990). With the rise of elected politicians in the power structure of the KMT, the party is gradually transforming itself from a political pact between the dominant mainlander state elite and subordinate native politicians to a more broadly based conservative alliance linking the state elite, local party factions and big business. To reconsolidate its power base under a more competitive political system, the KMT top leadership has little choice but to deepen its reliance on local factions and strengthen its partnership with the business elite. Confronted with challenges from a parliamentary opposition and activist social movements, the party has found it increasingly difficult to maintain the pretence that it is the embodiment of an all-class political alliance. As the remaining vestiges of the authoritarian regime disappear, the old sub-ethnic bias in the pattern of political dominance in Taiwan is rapidly fading and a nascent class bias is intensifying.

NOTES

1 As late as the early 1980s, the limited opening of national representative bodies for electoral competition gave rise to an island-wide coalition among independent candidates. They moved cautiously toward forming a quasi-party despite a stern warning from the government of its resolve to enforce the legal ban. On the eve of the 1986 election a formal party, the Democratic Progressive Party, was declared (Hu & Chu, 1992).

2 This began to change, however, in the 1970s under Chiang Ching-Kuo's 'Taiwanisation' policy under which increasing numbers of Taiwanese were appointed to senior bureaucratic posts.

3 During the 1970s (by which time the private sector had increased greatly), only two out of thirty seats on the party's Central Standing Committee were reserved for the business wing.

4 The four crown jewels of the Koos' empire are Taiwan Cement, China Trust, China Life Insurance and China Leasing (*Business Weekly*, Taipei, 18 August 1991). In terms of asset value, the Koo group is by far the largest on the island (*Excellence*, July 1992).

5 More than 98 per cent of Taiwan's registered companies have an annual

turnover of less than NT$40 million, equivalent to US$1.6 million (Wei 1991). The degree of decentralisation, however, is somewhat overstated by the official statistics provided by the Small and Medium-sized Business Bureau because, for taxation reasons, a company might be registered under more than one name.

6 For a documented account of the activities of a major state research organisation, the Industrial Technology and Research Institute, and its major branch, the Electronic Research and Service Organization, see Chu (1987a) amd Meaney (1989).

7 A series of semi-public firms were established under this model during the 1980s and early 1990s. Notable examples included United Microelectronics (in 1979), Taiwan Semiconductor (in 1986), Taiwan Photomask (in 1987), Lifeguard Pharmaceutical (in 1988), and Taiwan Aerospace (in 1991). These firms were all spin-offs of quasi-governmental research organisations.

8 Three more science parks were contemplated in 1991: a second high-tech science park in Jia-yi; an aerospace science park in Tainan; and a computer software science park in the suburb of Taipei.

9 Formerly the Bank of Communications.

10 For example, during the 1980s the opinions of the Industrial Policy Advisory Board were sought only by invitation and the influence of the board therefore oscillated from one minister to another. During the tenure of Hsu Li-teh and Vincent Siew the board was actively involved in policy consultation, but was virtually inoperative under Lee Ta-Hai and Chen Lu-an. Subsequently however, its policy review responsibility was institutionalised under the first Taiwanese minister, Vincent Siew (*Commercial Times*, Taipei, 25 November 1991.)

11 The voter has only one vote despite district magnitudes ranging from two to eight (or even more) members. Votes are not transferable to other candidates of the same party in the event that a voter's first (and only) choice has already made it past the post. Japan and Taiwan are the only countries in the world that currently have multi-member district SNTV electoral rule.

12 Vote-buying is integrated into the KMT nomination and campaign strategy and embedded in the local party apparatus, quasi-governmental organisations and communal networks.

13 In the 1989 election, for example, in most cases it cost about NT$30million to $40 million to get elected. For county magistrates, the price tag could exceed NT$100 million.

14 As in Japan, this is also the reason why most candidates inherited their electoral organisations from a father or mentor, who controlled a local faction (Rosenbluth, 1992).

15 Interview with the secretary general of the IBCPC, 15 January 1992. By comparison, the total turnover of the top 100 diversified business groups amounted to only 34 per cent of GNP in 1989 (China Credit Information Service 1991).

16 A group of oldtimers were forced to retire during 1988–89. They included

the head of the central bank, Chang Ji-cheng; the head of MEA, Lee Da-hai; and the head of the Finance Ministry, Chian Chun. In late 1992, the finance minister Wang Chien-shien (who proposed a sweeping reform of land transaction tax to curb the speculation) and the EPA head Jaw Shao-kung (who rigorously enforced the requirement of environmental impact assessment for all major industrial investment projects) were pressured to resign for their alleged anti-business inclination. Both subsequently stood for parliamentary election in defiance of the party leadership.

17 The automobile industry is a classic example; see Chu (1991).

18 For example, a China Steel project to create a new subsidiary producing steel frames met little resistance as a powerful political family of Kaohsiung city was incorporated into the tripartite joint venture (Wang 1991).

19 A good example is the passage of the *Labour Standard Law* in 1984. The business community did not mobilise itself to stop the passage of certain articles (that later became the source of many tense labour–management disputes in 1986 and 1987) on the false assumption that the law would not be seriously enforced.

20 The only intellectual base for the business community is a number of business magazines. It is interesting that the two leading business newspapers, *Commercial Times* and *Economic Daily*, belong to two mainlander media magnates, who consider themselves part of the party central leadership rather than the business elite.

21 In the case of the earlier-mentioned security transaction tax, the brokerage houses which settled for a 0.6 per cent rate apparently underestimated its long-term dampening effect on the trading volume. The Ministry of Finance was able to extract on average NT$600 million cash from the pockets of traders every trading day during the high seasons, and the overheated stock market was brought under control within about nine months as the fixed cost to short-term arbitrage took its toll.

22 Eight of the ten largest diversified business groups have developed some form of business tie-up with the KMT (*Fortune News*, Taipei, December 1991: 123). The list of the KMT's business partners also includes some foreign transnational corporations, such as AMOCO, General Electric, Kajima Construction and Nippon Electric Co.

23 None of the autonomous elite business clubs such as Young President Organisations or Rotary Clubs receives similar recognition. Nor are they overtly policy-oriented.

24 The Industry and Business Construction Planning Council (IBCPC), for example, is a party-created amalgamation. Membership is granted by the party, not IBCPC members themselves. Members are selected more for their political inclination and existing affiliation with the party leadership than any clearly defined economic criterion. The heterogeneity in business scale and orientation of its members prevents the IBCPC from developing a clear sense of group mission or a strong policy program on behalf of

its members—and also makes the group vulnerable to manipulation by party leaders.

25 A good illustration of this is the tug-of-war between the export-oriented sector and the state over policy towards mainland China. The state elite has resisted the persistent calls from the private sector, especially from the small and medium-sized enterprises, to loosen the restrictions on economic exchanges between Taiwan and mainland China. State officials have feared that the PRC might advance its reunification campaign by stealth through economic integration. As against this, however, the booming mainland coastal provinces have presented enormous investment and trade opportunities for Taiwanese business. Since 1984, despite stern warnings from state officials, local firms have been finding ways to circumvent existing legal barriers. A trickle of triangular or indirect trade through Hong Kong soon turned into a torrent. Similarly, Taiwanese investment capital flooded into Fujian and Guangdong through third countries at a pace beyond the imagination of state officials. Highly adaptive small and medium-sized enterprises simply overrode official bans. Eventually, the state was forced to modify its policy to accommodate what had become a *fait accompli.* In 1989 the ban on indirect exports to the mainland was lifted and restrictions on imports were substantially eased, as was the ban on investment through overseas subsidiaries in 1990. Had the government clung to an unenforceable ban, it would have been unable to monitor let alone regulate the flow of indirect trade and investment.

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5 Changing Patterns of Business–Government Relations in South Korea

Chung-in Moon[1]

The nature of relations between business and government in South Korea has been the subject of very extensive discussion for well over a decade now. Almost invariably, writings on this subject are grounded in the experiences of the developmental state over which Park Chung-Hee presided throughout the 1960s and 1970s. In most accounts of this period the Korean state is seen as being benign, interventionist and economically sophisticated—capable of prevailing over social forces and channelling market outcomes in line with the country's dynamic comparative advantage. Private enterprise is characterised as highly successful, entrepreneurial, but politically passive and even subservient. Since 1980, however, South Korea has been undergoing profound political, social and economic change. The neo-liberal reforms of Chun Doo Hawn's regime realigned the foundation of state–business relations, and the subsequent democratic transition launched in 1987 has reshaped the political landscape and the rules of engagement between the state and social forces, with business being no exception.

Rather than covering (yet again) the dynamics of business–state relations under Park Chung-Hee, this chapter attempts to explore changes in the relationship which have been unfolding since 1980. The chapter is organised into four parts. The first discusses theoretical approaches to the subject of state–business relations in South Korea. The second part traces the determinants of neo-liberal reforms under the Chun regime and how they have affected state–business relations. The third part explores the democratic transition and its impact on state–business relations; and the concluding section discusses comparative implications drawn from the preceding analysis of state–business relations under the Chun and Roh regimes.

BUSINESS, THE STATE AND POLITICS IN SOUTH KOREA

Debates on state–business relations in South Korea have been highly polarised between state-centric and business-centric approaches. According to the former, South Korea has had a 'developmental state' which is seen as being relatively autonomous from business pressures and even as a domineering entity which commands, manipulates and disciplines the private sector in line with clearly defined objectives and preferences (Haggard & Moon 1983; Haggard 1990; Johnson 1987; Jones & Sakong 1980; White & Wade 1984; Amsden 1990, 1991; Koo 1984; Wade 1990, 1992).[2] The state and business maintain close ties, but not on an equal footing: the state is pace-setter and guide, while business follows. State and business are interdependent, but in a vertical, asymmetric and, in some cases, hierarchical structure. Corporatist channels are state-controlled; the private sector is organised, subsidised and controlled by the state.

In this model, the Korean state is projected as being a unitary and internally cohesive actor with enormous strength, autonomy and capacity. These attributes have historical roots. South Korea inherited a strong state apparatus from the Japanese colonial occupation, and secured a material base for the control and co-optation of social forces through the strategic, and in some cases rent-seeking, distribution of Japanese properties and American aid. Anticommunism provided a 'hegemonic ideology' through which the state was able to sustain a mix of liberal economics and authoritarian politics. The authoritarian political template and executive dominance forged bureaucratic unity and insulated the decision-making machinery from social and political pressures, thereby effectively expanding the domain of state autonomy. The capacities of the state were further enhanced by the existence of a competent and relatively meritocratic bureaucracy. Endowed with historical legacies for autonomy and strength and aided by bureaucratic competence and an authoritarian mode of governance, the state is thought to have been able to orchestrate business, dictate market outcomes and achieve impressive economic performance. Lacking its own foundation of autonomy and strength, business has been dependent on and loyal to the state. Private firms have behaved like subcontractors 'competing and cooperating under state supervision' (Wade 1992: 315).

In contrast, the business-centric perspective, which stems primarily from the classical Marxist tradition, is more inclined to see the state as being 'captured' by business interests.[3] Its proponents argue that South Korea's developmental trajectory is littered with pro-business biases (Cho & Chung 1984; Cho 1990). The primacy of accumulation over distribution, the preferential treatment of business (especially big business) and the exclusion of the popular sector (particularly workers and farmers) through physical repression and ideological manipulation all suggest that the Korean state has been captured by the dominant capitalist class. In addition, it is argued that politicians are dependent on business for financial support. The close interrelationship through corporatist channels is seen as being indicative of the power of business rather than the state, and highlights the privileged access business enjoys by comparison with other societal sectors and groups.

In this interpretation, the Korean state is an instrument of class domination, with class interests being shaped by the subtle interplay of structural dependency on world markets and internal dynamics of capitalist development within South Korea (Park & Cho 1989). The private sector has grown over time in economic power, and now has resources to influence and manipulate the state. Increasing economic concentration has also expanded the structural power of big business in South Korea as successive regimes have relied increasingly on it as the primary agent of economic growth, which, in turn, underpins political support and social stability.

There have recently been some efforts to overcome the chasm between these two theoretical perspectives by developing such ideas as 'embedded autonomy' (Evans 1989), 'quasi-internal organisation' (Lee & Naya 1988; Lee 1992), and 'symbiosis' (Kim 1988). These alternative explanations reject the polarisation of state and business, and try to elucidate the nexus between the two by employing the concept of 'networks'.[4] In these views, state–business relations in South Korea are vertical in the sense that the state has legal authority and institutional capacity to dictate to the private sector. However, the vertical nexus is complemented by horizontal ties formed through formal networks (e.g. examination councils) and informal, organic (family/school/regional) networks. Vertical command and discipline are matched with horizontal consultation and consensus through shared corporate goals, producing harmonious relations between the state and business.

In all the various models discussed above there are places for markets, institutions and networks, but not for 'politics'. In a recent review article Robert Wade (1992) accuses Amsden and Haggard, two leading statists, of displaying 'thin politics' in their analyses of the political economy of South Korea. Wade charges that they failed to elucidate 'how rulers attempt to secure support, by what mix of policies, designed to appeal to which groups, and with what political success, and at what economic costs' (Wade 1992: 309). This is a powerful argument; economic policies are rarely chosen for public or private interests, but chiefly for regime interests such as consolidating power, expanding political support, and assuring political survival. Policy choices are then strategic actions to reward the friendly, exclude the hostile, and disorganise the dangerous (Bates 1981, 1988; Cheng 1990). Preoccupation with accumulation often undermines popular support and can jeopardise regime survival. When this occurs, rulers may pursue an anti-business stance. On the other hand, an emphasis on legitimation through distributive justice can retard accumulation and also threaten regime survival. To cope with economic downturns, therefore, rulers return to pro-business policies (Hirschman 1979). Faced with these conflicting imperatives, the policy preferences of rulers tend to oscillate from one to the other, depending on the political task at hand, and this influences state–business relations.

Similarly, we should view business as neither a passive agent nor a dominant class. It also engages in a set of strategic actions as dictated by the logic of corporate survival and expansion. Business might well choose a strategy of compliance and cooperation with the state if more benefits can be expected by doing so. It can also attempt to modify state behaviour through lobbying, protests, blackmail and networking. In the worst case, business can pull itself out of (inter)dependence with the state and seek its own survival and expansion through such autonomous actions as diversifying political ties and even creating its own political shield (e.g. political parties).

In any national setting, the state and business are not atomistic actors; their strategic actions are constrained by regime type. The nature of the political regime affects the scope, depth and methods of political interactions between the two. Under a democratic setting, business might have greater political space, more formalised channels of interest articulation and deeper penetration, while the state might be delimited in its scope of action. In contrast, an authoritarian setting makes it easier for the state to prevail over business and to insulate its decision-making processes from business pressures as the political space for the private sector is narrowed, and interest representation limited, informal and segmented. In what follows, I will examine state–business relations under the Chun and Roh governments by focusing on the politics of strategic actions and regime dynamics.

DISSOLVING THE DEVELOPMENTAL STATE?

The pattern of state–business relations under the Chun regime differed radically from that under Park Chung-Hee. Park accelerated economic growth, heavy industrialisation and export expansion by forming a 'developmentalist' coalition which co-opted and mobilised big business, while maintaining tight control over the popular sector. The coalition brought the state and business closer and steered the economic miracle through consensus and coordination. When Chun Doo Hwan came to power, he embarked on a different path. He attempted to dissolve the developmental state by cracking the hegemonic pact between the state and business through aggressive pursuit of neo-liberal reforms. The previously symbiotic state–business relationship became uneasy and even conflictual. This change was a calculated move to overcome the political and economic crises which threatened the very survival of the fledgling regime. The political crisis stemmed from Chun's unconstitutional seizure of power in 1979 on the basis of military intervention and his subsequent repressive and authoritarian rule (Moon & Kang 1992). The economic crisis—a sharp slowdown in the rate of growth—was the result of economic mismanagement by the Park regime (World Bank 1980; Economic Planning Board 1986; Moon 1988).

On the political front, the new regime responded to challenges to its authority by tightening controls in the name of national security. As a way of disciplining, co-opting and excluding social forces selectively, extensive purges were undertaken targeting opposition political leaders, bureaucrats, journalists, labour leaders, and radical students. 'Social purification' was also extended to the private sector with the new military government raising the possibility of prosecuting big business on charges of illicit wealth accumulation (*Dong-A Ilbo*, 18 December 1979; *Hankuk Ilbo*, 19 December 1979; Suh 1991: 141–3). Purging the large corporations (or *chaebol*) was seen as a most effective way to distance the new regime from the old one and to demonstrate its clean, revolutionary image. Collusion between government and business (*junggyungyuchak)* under the auspices of the state-led heavy industrialisation drive in 1979 was blamed for both economic difficulties and political corruption.

The Federation of Korean Industries (FKI), representing interests of big business, attempted to resist the purge. On 5 January 1980, the FKI held a press conference and argued that it was not desirable for the government to make big business a scapegoat in every regime change and that the preferential treatment of big business was not an act of corruption. Business leaders also argued that the *chaebol* were the primary agents of exports, growth and employment, and that any attempt to 'punish' big business in a period of economic hardship would only exacerbate economic problems—possibly even undermining political and social stability. At the same time, however, they also made plain that they were willing to comply with, and support, the new government (Choi 1986: 220). Like Park Chung-Hee nearly two decades earlier, Chun sought to capitalise on this and accepted the pledges of loyalty in return for dropping the corruption charges and pledging not to raise the issue of illicit wealth accumulation (*Dong-A Ilbo*, 18 June 1980). Unlike the early Park years, however, this was not the beginning of a cooperative partnership—the road ahead for business–state relations was to prove increasingly rocky.

On the economic front, reviving the country's flagging economy was the ultimate imperative. The government's policy response was broadly neo-liberal in nature. The choice resulted partly from the expansionary or Keynesian origins of the crisis and partly from the transmission of monetarist ideas concerning economic management (Amsden 1991; Haggard & Moon 1990). Economic bureaucrats with a monetarist bent began to replace those of a Keynesian disposition and introduced reforms featuring a form of 'structuralism using orthodox instruments' (Foxley 1983: 17). They aimed at stabilising the economy through short-term macroeconomic adjustment and at enhancing international competitiveness by restructuring industries and liberalising important elements of the trade, investment and financial regimes. These various reform measures carried very important implications for political alignments.

Restoring macroeconomic stability was expected to enhance broad political support from the 'silent' majority of consumers, savers and, especially, the middle class. Given that the middle class (i.e. owners of small and medium-sized firms, and professional, managerial and technical workers) had constituted the largest part of the Korean population from the 1970s onwards, it was a natural target for a regime seeking to boost its popular appeal (Suh 1984; Moon 1988). However, while macroeconomic stabilisation measures favouring the middle class may have won the regime some new supporters, they also provoked opposition from other sectors of the economy. Farmers were hit by cuts to grain and fertiliser subsidies, labour was subjected to wage freezes and tight corporatist controls, and the business sector was squeezed by tight credit (Haggard & Moon 1990). Of even greater significance for business than these macroeconomic reforms was the government's push for improved international competitiveness via industrial restructuring and liberalisation. This requires detailed discussion.

The drive for industrial restructuring was guided by two principles: rationalisation and a reduction of business concentration (Economic Planning Board 1982). The first stage of industrial restructuring involved the thoroughgoing reorganisation of six problem industries (especially power-generating equipment and automobiles) in which serious surplus capacity had emerged as a result of duplicated investment and poor planning and coordination. In the ensuing shake-up, whole lines of business were consolidated by mergers, particular products were assigned or reassigned to particular firms and foreign participation was invited. These measures had a major impact upon the fortunes of the *chaebol* and illustrated the state's continued power over big business. Some conglomerates (e.g. Daewoo) benefited from the reorganisation, while others that were less cooperative (e.g. Hyundai) suffered. The restructuring was achieved by discretionary industry-specific and even firm-specific state intervention. This was somewhat ironic given that the underlying theme of the whole neo-liberal reform drive was to move towards a more market-oriented approach featuring an indirect, non-discretionary, industrial policy framework (Rhee 1991: ch. 10; Chung 1991: 186–90).

Stronger and apparently more anti-business measures were yet to come. In September 1980, the new government announced sweeping reforms to reduce business concentration. These included: the forced sale of 'idle' real estate held by the *chaebol*; the rationalisation of the *chaebol*'s corporate structure through the forced sale of non-essential subsidiaries; tight credit control over big business; stringent supervision of loans given to the *chaebol*; and a prohibition of bail-out loans to troubled firms (*Dong-A Ilbo*, 28 September 1980). Twenty-six of the largest *chaebol* were formally singled out and instructed to sell off 166 subsidiaries (from a total of 631) and to dispose of 459 tracts of land (Lee 1985:146). To achieve corporate compliance with this administrative guidance, the government relied on credit allocation, tax investigation and even naked intimidation by the security agencies as instruments of enforcement. Confronted with this radical assertion of state power, business could not but comply with government demands.

Other measures to reduce industrial concentration included the enactment of the *Monopoly Regulation and Fair Trade Law* in April 1981. This covered a wide range of issues including supervision of the leading producers in each sector, regulation of business concentration and protection of subcontractors. Special emphasis was placed on preventing conglomerate concentration through cross-investment, reciprocal buying and cross-subsidisation among *chaebol* subsidiaries (Lee 1985; Lee & Kim 1984; Lee & Lee 1990). More broadly, the government sought to give greater priority to small and medium-sized firms. Henceforth commercial banks were required to set aside 35 per cent to 55 per cent of their newly available lendable funds for these firms. At the same time, tax laws were amended by reducing the preferences previously granted to the *chaebol*, and a Long-term Plan for the Promotion of Small and Medium-sized Industries was established (*Business Korea*, December 1984: 28). The promotion of small and medium-sized firms was not solely motivated by political considerations. The existence of a healthy small and medium business sector implied a greater degree of product diversification, thereby assisting the country to cope with protectionist pressures from advanced industrial countries more effectively. Added to this, the growing dependence of big business on parts and components from Japanese suppliers induced the government to foster the promotion of small and medium-sized firms in this area.

Perhaps the most controversial aspect of industrial restructuring was the management of ailing industries (Choi 1991; Nam 1991). In implementing its big push for industrial deepening in the 1970s, the government designated selected industries (e.g. heavy industry, shipbuilding, overseas construction and shipping) as strategic industries, and directed a large volume of preferential credit to assist them. Notwithstanding this support, when recession hit in the early 1980s these industries experienced severe difficulties. Rescuing them would not only be extremely costly, but also tantamount to relinquishing the pro-market ethos of the whole neo-liberal reform drive. On the other hand, abandoning them had the potential to create economic chaos and, by extension, political difficulties. The government opted for a middle path of inducing healthier firms to absorb insolvent firms. Between 1985 and 1988, some 78 troubled firms were restructured on this basis. The terms of restructuring were extremely generous to the stronger firms and at the expense of those being taken over, thereby creating widespread public suspicions of political vendetta and favouritism. Among the benefits extended to the stronger firms were a 5–30 year grace period for normal interest payment (1.6 trillion won); concessional loans (2–10 per cent interest rates per annum) payable over 5–30 years (4.2 trillion won); seed money to compensate for the estimated loss from acquisition of defaulted firms (460 billion won); and write-off of principal (990 billion won). In order to cover this financially, the Bank of Korea had to provide three trillion won of special credit. Forty-two per cent of the total loss of 451 billion won arising from financial assistance for rationalisation was replenished by the Bank of Korea (Nam 1991: 24–5)

Liberalisation of the financial sector was another key element of the economic reform drive initiated by the Chun regime in the 1980s (Nam 1991; Choi 1991). Financial reforms were mixed blessings for big business. By introducing a comprehensive credit management system, the government attempted to reduce credit concentration in the hands of the *chaebol*. One element of this was the government's plan to introduce a 'real name' financial transaction system in a bid to stamp out widespread tax minimisation and concealment of financial transactions under false names. More broadly, the move was designed to restore public confidence in the integrity of the financial system in the wake of a series of financial scandals. Not only would the reform eliminate the dual structure of financial institutions (namely, formal and informal), but it promised also to increase tax revenue through the effective detection of financial dealings under false names and illicit accumulation of wealth through curb market speculation. If implemented, this measure would have been a heavy blow to big business.

Along with promoting economic efficiency, a central aim of financial deregulation was to restrain big business by promoting competition in the allocation of financial resources. In practice, however, far from restraining the *chaebol*, financial deregulation opened up new opportunities for them. The privatisation of the state-owned commercial banks enabled the *chaebol* to gain a toehold in an industry long closed to them.[5] The lifting of restrictions limiting competition among different types of financial institutions resulted in a dramatic upsurge in non-bank financial institutions (NBFIs)—which include investment and insurance companies and direct credit markets for corporate bond and commercial papers. Here again, the *chaebol* moved aggressively into the newly opened industry, seeing NBFIs as a novel source of finance which was free from tight government controls. Internationalisation of the banking and financial sector and subsequent entry of foreign banks and financial institutions also opened alternative sources of financing for big corporations, thereby further reducing their dependence on the government.

A similar pattern emerged with the liberalisation of the trade and investment regimes. These reforms were the result of both bilateral pressures from the United States and the government's desire to create a more competitive business climate which would restrain the monopoly and oligopoly positions of the *chaebol*. Again, however, rather than restraining big business, the changes actually strengthened their position. Little real progress was made in breaking up established monopoly or oligopoly privileges enjoyed by big business and, in many of the areas where imports were liberalised, big business was able to capture new niche markets. For instance, the *chaebol* became the dominant import agents for goods and services ranging from children's toys and foodstuffs to luxurious automobiles. A similar story applied to the liberalisation of foreign investment; the net effect was to facilitate access to new capital (in the form of joint ventures) for big corporations. Rather than easing economic concentration, these measures in fact intensified it.

More broadly, the underlying theme of the whole neo-liberal adjustment drive was the transition to an economy in which the private sector and the price system would play a greater role in determining the allocation of resources. In line with this, the Chun government emphasised 'indicative planning' rather than strategic management, non-discretionary and market conforming intervention rather than discretionary intervention and industrial targeting, and consultation and consensus between the state and business rather than unilateral administrative guidance. The transition was, however, erratic and confused. As noted above, discretionary intervention continued, consultation with the private sector was scarce, and 'consensus' was one-sided, taking the form of unilateral administrative guidance.[6]

The Chun regime made life uncomfortable for much of the corporate sector, squeezing the *chaebol* for both political and economic purposes. The anti-corruption campaign of the early 1980s further damaged the public standing of the *chaebol*. Credit restrictions severely contrained cash flows for big business and the enactment of the Monopoly Regulation and Fair Trade Law imposed limits on corporate expansion. And although not all *chaebol* were losers in the forced merging and consolidation of troubled firms, most suffered. In his memoir, Chung Joo-Young, who headed the FKI during the Chun years, declared: 'The Fifth Republic was the most painful period for businessmen' (1991: 224). Through emotional testimonies at National Assembly hearings on corruption and abuses of power under the Fifth Republic, former owners of conglomerates victimised in the name of industrial rationalisation offered telling evidence corroborating Chung's claims (National Assembly Record 1989).[7]

More remarkable than the depth of business hostility towards the Chun regime was the fact that the peak big business organisation, the FKI, was often prepared to publicly disagree with the government—something very rare during the Park era. Criticising neo-liberal reforms as textbook economic policies detached from reality, the FKI openly opposed the monopoly regulation law, tight credit controls and industrial rationalisation. The FKI pursued this cause through parliamentary hearings, the mass media and meetings with political leaders and economic bureaucrats. However, the scope for effective political representation was severely constrained by the restrictive and authoritarian political framework that was in place. While there were indeed corporatist channels for business–government consultation, they were principally the tools of government, with business access depending on variable personal networks and loyalties. Those who contributed hefty political funds to the regime enjoyed big rewards. Those who did not, suffered major setbacks. Selective co-optation and exclusion of individual *chaebol* and the resulting division within the corporate sector weakened the FKI as a peak organisation. On top of this, the naked power of the regime and its preparedness to use coercion also constrained the political actions of business.

If one characteristic of the Chun period was continuing restrictions on political action by business, another was the emergence of clearer limits to state power. Despite discretionary interventions and coercive disciplining, neo-liberal reforms did not achieve their intended outcomes vis-a-vis big business. Although industrial reorganisation did indeed take place, there was little progress in reducing the level of economic concentration. The *chaebol* were indeed forced to sell off a total of 166 subsidiaries in 1981, but within four years 120 new subsidiaries had been acquired. Similarly, although the *chaebol* were forced to sell some of their real estate, within a short time they had required land holdings worth 20 times more than those they had released. The rationalisation of troubled firms was also of doubtful benefit, producing questionable corporate mergers at a high commercial and political cost. The banking and financial reforms fared little better. Paradoxically, perhaps, banking liberalisation further limited small and medium firms' access to bank credit because banks under the new system were reluctant to give loans to small firms that lacked collateral. The rise of non-banking financial institutions and the internationalisation of banking and financial markets provided the *chaebol* with alternative sources of corporate financing, thereby reducing their dependence on the state. The reduction of discretionary credit controls had a similar effect, reducing corporate vulnerability to government arm-twisting. And, in the face of business hostility, the introduction of 'real name' transactions in banking was postponed indefinitely. Likewise, as the 1985 general election approached the government began backsliding on its attempts to limit credit flows to the corporate sector.

In sum, facing a legitimacy crisis, the Chun regime sought to woo the middle class by pursuing neo-liberal reforms and attempting to restrain and distance itself from big business. The anti-*chaebol* stance and the resulting business opposition signalled the end of the pattern of collaboration developed under the auspices of Park Chung-Hee's developmental state. Paradoxically, however, rather than constraining big business or curtailing economic concentration, the government's tough anti-big-business measures actually strengthened the position of the *chaebol*.

THE RISE OF UNRULY PARTNERSHIP

State–business interaction in South Korea under the regime of Roh Tae Woo (1987–92) was also marked by serious tension, but the relationship was more variable, fluctuating between conflict and co-operation. The striking development during the Roh years was the growing political assertiveness of big business. These changes took place within the context of a fundamental shift in the character of the South Korean political system in the direction of democracy. Democratisation and the rise of electoral politics have radically changed the rules of engagement between business and government.

Roh Tae Woo, general-turned-politician, succeeded Chun by narrowly winning the presidential election in December 1987. Despite the close result Roh was in a much better position than his predecessor in terms of both political legitimacy and economic performance. Although he won only 36 per cent of electoral votes, he came to the presidency through a relatively open and fair electoral contest. The national economy was also prospering. The coincidence of the so-called 'three lows' (low oil prices, low interest rates and low exchange rates) was conducive to strong export growth, and macroeconomic prices had stabilised following the neo-liberal reforms implemented under Chun. But Roh confronted challenges as well. His personal ties to the previous regime were a liability and he faced a new and unfamiliar political landscape. The democratic transition set new norms, rules and procedures of political engagement, and fostered the proliferation of politically active social groups. Freedom of association and expression drastically expanded the political 'space' available for these groups. The new composition of the National Assembly, in which three opposition parties formed the majority, also fundamentally delimited the new regime's rule-making capacity.[8] Even more critical, perhaps, were the rising expectations of the masses and growing demands for equality and fairness.

In strategic terms, Roh followed a political path similar to that of Chun: he sought to distance himself from the previous regime, co-opt the middle class and squeeze big business. This strategy was well reflected in his presidential election campaign platforms. Advancing the politics of *bopong saram* (ordinary people) as his campaign catchphrase, he foreshadowed both the severance of political ties with the previous authoritarian regime and a renewed push to curtail the position of the *chaebol*. Such a stance was certain to resonate with the widespread public hostility towards big business. Throughout 1988 and early 1989 Roh pursued a tough anti-big-business line. The government announced the implementation of the 'public concept' of land ownership from 1990 which would limit land ownership, especially by big business. A comprehensive land tax system designed to prevent real estate speculation was also introduced, as were important and progressive reforms to labour laws. At the same time, the government attempted to squeeze the *chaebol* by pursuing measures to reduce business concentration by again limiting credit flows to big business and restricting the scope for horizontal corporate expansion. Also, in this vein, the government pledged to introduce the earlier, abandoned 'real name' financial transaction system by 1991.

Moon Hee-gap, then chief economic secretary to President Roh, neatly summed up the rationale behind these populist measures in a published interview: 'Any further delays in these reforms would invite revolution, not incremental changes' (*Wolgan Chosun*, October 1989: 162) The dangers for the regime alluded to by Moon were real. The economy was overheating and public dissatisfaction was growing. The 1987 presidential and 1988 parliamentary elections and the large current account surplus of 1986–88 pumped money into the economy, with much of it finding its way into real estate and stock market speculation, thereby contributing to skyrocketing land prices and housing rents and an increasingly conspicuous gulf between the rich and the poor.

Both the government and the public regarded the *chaebol* as the cause of these problems. As already seen, notwithstanding the attempts of the Chun regime to contain big business, the *chaebol* continued to expand rapidly. The combined turnover of the nation's 30 leading conglomerates reached 107.9 trillion won (US$161 billion) in 1988—equivalent to 94.8 per cent of South Korea's 1988 GNP (*Business Korea*, November 1989: 21). This growth was fuelled by access to a huge share of bank credit. As of August 1989, the 30 top *chaebol* acquired 44 trillion won (US$65 billion) in credit from banking and non-banking financial institutions, equivalent to 38.9 per cent of South Korea's 1988 GNP and 41.4 per cent of total credit from banking and non-banking financial institutions (*Business Korea*, November 1989: 22). More problematic still was the *chaebol*'s deep involvement in real-estate and securities markets using bank and non-bank loans. By the end of 1988, the top 30 *chaebol* held 10.1 trillion won (US$15 billion) in real estate at home and abroad, and 6 trillion won (US$9 billion) in securities (*Business Korea*, November 1989: 22).

Despite these developments and the existence of widespread public concern, the anti-big-business campaign did not last long. The corporate sector began to stage careful but formidable counter-offensives. Koo Ja-kyung, chairman of the Lucky-Gold Star Group, who succeeded Chung Joo-Young as chairman of the FKI, warned politicians—both ruling and opposition—of potential retaliation through the discretionary use of political contributions. Reflecting FKI concerns over a series of anti-business measures, including amendments of labour-related laws, Koo called for the rationalisation of campaign donations, and declared that the FKI would henceforth provide donations only to politicians willing to support and protect business freedom.

This was a dramatic move: Koo's statement violated the long established convention of business leaders refraining from strong political comments in public. His remarks were a double-edged challenge. On the one hand, they were a warning to Kim Dae Jung's Party for Peace and Democracy which was adopting a populist and anti-business stance; and, on the other, they were tantamount to criticism of the government for its lukewarm and even hostile attitude toward big business.

The FKI's tough stance brought about internal divisions within the political elite. Conservative segments within the ruling Democratic Justice Party began to take an overtly sympathetic attitude toward big business. Park Tae-Jun, chairman of the ruling party and former vice-chairman of the FKI, openly criticised the reformist push by the government to place limits on the *chaebol*. Another senior politician of the ruling party, Park Jun-kyu, speaker of the National Assembly, went even further by saying that, 'current measures to prevent revolution could invite revolution *per se*' (Lee 1991: 258). Both men were keenly aware of the private sector's mounting hostility to the Roh regime. Kim Dae Jung's party also made a concession by accommodating the FKI's views in amending labour-related laws.

In the second half of 1989, Roh faced a deteriorating national political situation, which he went so far as to describe as 'total crisis' (S.J. Kim 1991a: 211–44). Progressive reforms were not sufficient to satisfy even ordinary citizens. Workers became more volatile than ever before. As land prices shot up by a record 31 per cent in 1989, housing rental prices increased and living conditions for most South Koreans worsened. More fundamentally, after three years of strong growth, the economy began to falter with the growth rate falling to 6.5 per cent in 1989, down from an annual average of 12 per cent between 1986 and 1988. Imports rose and exports sagged. Indeed, in 1989, for the first time in that decade, exports actually declined (–6.3%). In the same year the surplus on the current account fell from $14.1 billion to $5.1 billion. In the midst of these economic troubles the Roh regime faced opposition from all fronts, the left, the right, and even the centre.

In attempting to respond to these problems the government began to realign its political, bureaucratic and policy strategies. The political response to the crisis was the formation of a grand conservative ruling coalition—the Democratic Liberal Party—by co-opting, and merging with, two opposition parties (Kim Young Sam's Reunification Democratic Party and Kim Johg Pil's New Democratic Republican Party). The coalition represented one of the most significant political realignments in South Korea's recent history and fundamentally reshaped the balance of power in the National Assembly, turning Kim Dae Jung's party into a meagre opposition force. The move also reflected the regime's ideological reaction to the crisis. Since the democratic transition in 1987, South Korean society had shown a growing polarisation between the conservative and progressive camps. The advent of democracy placed the right-wing, conservative camp on the defensive, and enabled the progressives to take the political offensive. However the formation of the Democratic Liberal Party as a mega-conservative grouping (modelled on the Japanese Liberal Democratic Party, even in its title) halted the advances of the progressive camp, and the advantage swung back to the conservatives and their pro-big-business policies.

The political realignment was soon followed by changes in the economic bureaucracy. Roh reshuffled the economic cabinet led by Cho Soon and Moon Hi-gap, who had consistently advocated progressive reforms. Lee Seung-Yoon, a pro-business Keynesian expansionist, became the new head of the economic planning ministry. Other economic ministerial positions were also filled by pro-business figures. A remark made by Han Seung Soo, the new minister of commerce and industry, encapsulated the change: 'Our policy will not be to try to restrict the growth of the *chaebol* as in the past' (*FEER*, 29 March 1990). The new economic cabinet began to delay progressive economic reforms and showed signs of returning to the high growth policies of the past.

In line with the political and bureaucratic shake-up, the government announced a series of measures on 4 April 1990 to boost the private sector. The won was depreciated (after having appreciated for two years), credit controls were eased, interest rates were improved and the money supply was allowed to expand. Among other concessions designed to rekindle investor confidence in the corporate sector, the 'real name' financial transaction system was again postponed; labour-related laws were watered down to reflect business interests; the earlier mentioned 'public' concept of land ownership was entirely scrapped; tough real estate tax measures were eased (with the maximum tax rate on speculative land holdings being cut from 5 per cent to 2 per cent); and the impact of a progressive tax on consolidated nationwide landholdings was softened (S.J. Kim 1991b: 490–504; Sohn 1991a: 460–9). With a comfortable majority in the National Assembly, the Roh government could easily override parliamentary opposition to these changes.

While representing a major shift in policy emphasis this was not, however, a complete reversal of direction. Although the government was attempting to restimulate the economy, public hostility towards big business encouraged a more focused and selective strategy for containing the largest *chaebol*. In a remarkable move in May 1990, the government ordered the country's 49 largest business groups to sell off their idle land and buildings within six months as a way of reducing real estate speculation. Securities and insurance firms were ordered to dispose of their surplus land holdings within three months. All land not sold by the government deadline would be transferred to a state-owned development agency (Sungup Gongsa) at prices set by the government. Those who failed to comply with the deadline set by the government would be denied access to commercial bank credit, forced to repay outstanding bank loans immediately and subjected to extensive tax investigation (*Business Korea*, June 199 0:18–19; *Dong-A Ilbo*, 9 May 1990).

In March 1991, the government launched another major initiative aimed at lifting the competitiveness of the manufacturing sector. One element of this was a further attempt to reduce business concentration. The top 30 *chaebol* were required to nominate up to three of their subsidiaries as 'core business' and strongly encouraged to specialise in these industries by way of a relaxation of existing restrictions on bank lending. 'Non-core' subsidiaries were required to reduce their outstanding bank loans and freeze new borrowing at current levels (Sohn & Cho 1991: 24).

This emphasis on economic deconcentration was established as a central policy target by the Economic Planning Board later in 1991 (EPB 1991). The guidelines stressed the strengthening of legal, administrative and taxation systems in order to detect and prevent cross-investment, cross-subsidisation, cross-payment guarantees, and illicit concessions and inheritance of corporate stocks between and among *chaebol* owners as well as violations of the Monopoly Regulation and Fair Trade Law. In tandem with this, the government began deliberating on more drastic measures to abolish group chairmanships and offices of group planning and coordination, which were considered the organisational vehicles of the *chaebol*'s expansion. Among the measures was the suggestion that conglomerates in which more than 50 per cent of equity was held by the owner-chairman and his immediate relatives be subject to compulsory government audits. This broad policy orientation hardened with the unveiling of the seventh Five-Year Economic Plan (1992–96) in November 1992, which argued that *chaebol*-centred economic growth had reached the point of diminishing returns.

As in the past, squeezing selected *chaebol* had a political as well as an economic dimension. Both parliamentary and presidential elections were scheduled to be held in 1992. Attacking big business was calculated to attract votes from the middle and lower classes. According to one survey, 97 per cent of respondents believed that the *chaebol* had accumulated their wealth by illegal and unfair means (*Seoul Shinmum*, 3 November 1991). Interestingly, a survey of companies by the Fair Trade Council and the Korean Chamber of Commerce showed that 90 per cent of respondents regarded business concentration as the most negative aspect of the South Korean economy (*Seoul Shinmum*, 3 November 1991). Sentiments of this sort strengthened the government's resolve to tackle big business concentration.

Predictably, the *chaebol* were decidedly hostile to the government's policy initiatives. Their position was clear: the real estate fiasco was not triggered by speculation, but by election promises and the government's mismanagement of housing policy. Economic concentration was also a natural by-product of capitalist development, not a contrived creation resulting from unfair practices on the part of the *chaebol*. The FKI, the representative body of big business, argued that given the inevitable process of internationalisation, artificially dissolving business conglomerates would be counterproductive. Going on to the offensive, the FKI called for protection of business independence, accelerated privatisation of commercial banks, liberalisation of financial institutions, lifting of restrictions on credit allocation, and abolition of the government's ceiling on cross-investment among subsidiaries of *chaebol* (*Hankuk Ilbo*, 14 May 1991; *Hankuk Gyungje Shinmum*, 9 May 1991).

Corporate hostility to the government's moves was heightened by the fact that, notwithstanding the shift to a more democratic political framework, the government had initiated the changes unilaterally. There had been virtually no consultation between the presidential office and the leading business associations, and only limited lower level communication with economic bureaucrats. Despite growing dissatisfaction, the FKI had little scope for significant political action. Since the departure of Lucky-Gold Star chief, Koo Ja-kyung, as head of the FKI, the organisation was weakened politically by the unwillingness of other company heads to take on the leadership role. Company heads were reluctant to do so both because of the perceived ineffectiveness of the FKI as a peak organisation and because of the government's divide-and-rule tactics, which pitted one *chaebol* against another. As a result the chairmanship of the FKI was given to a hired gun, Yoo Chang-soon, a former prime minister—a move which seemed to leave the organisation more open to government suasion.

Being cornered by the government, political parties, labour and progressive social forces, the private sector formed the Council of Economic Organisations, comprising the FKI, the Chamber of Commerce, the Federation of Small and Medium-sized Firms, the Korea Trade Association, the Korean Association of Banks and 80 industrial organisations. In practical terms, however, this move was only of limited political significance as the new council embraced a very broad range of business interests. This, together with the decision not to allow formal lobbying, served to further weaken lines of communication between business and government. The fact that business organisations provided very substantial campaign donations at election time did little to counter this trend. (In the 1990 local elections alone, the FKI and the Association of Banks each donated five billion won (Lee 1991).)

A dramatic illustration of the deteriorating relationship between the corporate sector and the state unfolded in late 1991 and 1992. It centred on the tax status of Hyundai, one of the very largest conglomerates. The National Tax Agency alleged that Chung Joo Young (the founding chairman of Hyundai) and his family had evaded inheritance and donation taxes through illegal stock transactions, and ordered Hyundai to pay 136.1 billion won (US$180 million) in back taxes—roughly half by 30 November and the remainder by 10 December—or face additional fines of up to 25 per cent of the total amount. Rather than backing down and reluctantly paying as might normally have been expected, Chung openly defied the order. More than this, he went on the counter-offensive and established a new political party (the Unification National Party) to challenge the governing party at the upcoming elections for the National Assembly. Incensed by this extraordinary move, the regime hit back. In April 1992 a number of senior Hyundai executives (including one of Chung's sons) were arrested for alleged tax evasion, corruption and violation of environmental laws. Hyundai subsidiaries suddenly encountered difficulties in tendering for government contracts and, most dramatically of all, Hyundai Engineering (one of the largest Hyundai subsidiaries) was thrown into technical financial default when financial authorities temporarily refused approval for it to raise money on the corporate bond market (*FEER*, 23 April and 7 May 1992). Ultimately a negotiated compromise was reached but not before Chung Joo Young had actually contested the presidential elections himself. Chung Joo Young's stand against the state produced mixed reactions within the business community; some were impressed while others were critical of the move. Most stood back, adopting a wait-and-see attitude.[9]

More than any other single event, the Hyundai episode epitomises the changing nature of relations between business and the state. Although there was no obvious winner or loser, the clear message was that at least some business leaders were no longer prepared to respond meekly to unwelcome government actions.

CONCLUSION

The pattern of relations between business and the state in South Korea has undergone major change in recent years and no longer corresponds with the 'textbook' image deriving from the days of Park Chung-Hee's developmental state. The institutional and personal ties between the state and business have frayed under the Chun and Roh regimes. The stern but stable state-directed symbiotic partnership of the 1960s and 1970s has been replaced by a more conflictual and erratic set of relationships.

Frustrated by a fluctuating policy environment, business has become more assertive politically, more willing to criticise the government openly and even to attempt to defy it. This would have been inconceivable under the Park regime. The internationalisation and liberalisation of the Korean economy during the 1980s reduced the dependence of business upon selective state assistance and thereby lessened the vulnerability of business leaders to government arm-twisting. This trend should not, however, be exaggerated. Particularly in the financial sector the state's commitment to deregulation has been half-hearted, and as a result formal and informal mechanisms for applying industry-specific and even firm-specific pressure remain. In short, there can be no doubt that the Korean state still retains considerable capacity to intervene in the marketplace and frustrate or even coerce the corporate sector.

Nonetheless, the situation today is much changed from that in the era of the developmental state. In addition to the structural constraints on state power imposed by a market economy (Lindblom 1977), the advent of a more open economy and a more democratic political framework has increased the scope for business groups to advance their interests directly. Conversely, political leaders are having to focus more closely on developing their bases of popular support. These developments suggest strongly that far greater attention must now be given to 'politics' as an explanatory variable of business–state relations.

The institutional configuration of the state and formal and informal networks between the state and business are necessary but insufficient conditions for accounting for the dynamic interactions between the two. Rulers include, co-opt and reward business only if the private sector is perceived as assisting regime survival. Firms are ignored, excluded and even punished when and if they emerge as political liabilities. By the same token, business cannot be viewed as simply a passive agent subservient to the state. Depending on the calculation of interests and on resource availability, the private sector can pursue diverse strategies involving compliance, lobbying, protest and even blackmail. State–business relations should therefore be seen as a function of strategic interactions between the two, as dictated by the logic of both regime and corporate interests, subject to the constraints imposed by the type of political framework in place.

Finally, the evolution of South Korea's political economy highlights the fact that, particularly in rapidly industrialising countries, patterns of state–business interaction are very much subject to change over time (Haggard & Moon 1990; Moon 1990; Doner 1992). The much-vaunted developmental state was a transitional configuration which contained its own limits and contradictions (Kim 1992). Conditions such as economic backwardness, authoritarian politics and the corporatist culture which underpinned it have now passed. Consequently, both scholars and policy makers should be very wary of attempts in other settings to emulate the pattern of business–government relations embedded in the Korean developmental state.

NOTES

1 I would like to thank Charles Davis, Stephan Haggard, Iyanatul Islam, Eun Mee Kim and Andrew MacIntyre for their comments, Kyuman Bym for logistical support during my research trip to Seoul, and Chang-Hoon Chung for research assistance.

2 There are of course variations within the statist perspective. See Cotton (1992) and Kang, Kim et al. (1991).

3 In understanding state–business relations, the neo-Marxist perspective is closer to the statist view than to the classical Marxist position because of its emphasis on the structural autonomy of the state. See Kang, Kim et al. (1991), Sohn (1991a), Choi (1985), and Lim & Baek (1986) for a general discussion and application to the South Korean case. It should be noted that I am setting aside the ideas of neoclassical economists here. Although business-centric, this school of thought is not principally concerned with power relations.

4 The 'network' perspective has been inspired by recent works on state–business relations in Japan. See Okimoto (1989), Murakami (1987),

Muramatsu & Krauss (1987) and Yeom (1989) in the Japanese context, and Shin (1992) for its application to South Korea.

5 Nonetheless, the Bank Law limited the *chaebol*'s holdings in the privatised banks, and their lending practices were carefully monitored and regulated to avoid their capture by them.

6 The Chun regime initiated a Civil Government Consultative Council made up of top economic bureaucrats, business people, economists and journalists. Although the Council was designed to serve as a forum for differing public opinions on economic policies and for forging consensus, it did not work as intended. The original plan to hold meetings every Friday was scrapped, and they became infrequent and irregular.

7 Yang Chung-mo, the founder of the now defunct Kukje, then the sixth-largest *chaebol*, claimed that the government wilfully let his group go bankrupt because he refused to contribute political funds to the Chun regime. Major beneficiaries under the Chun regime included Daiwoo, Samsung and Hanjin.

8 The ruling Democratic Justice Party gained 125 seats in the April 1988 general election, far short of an absolute majority. When combined, the opposition parties commanded 159 seats (70 for the Party for Peace and Democracy, 59 for the Unification Democratic Party, and 35 for the New Democratic Republican Party).

9 It has been rumoured that the real motive behind Chung's decision to form a political party was closely related to the survival of the Hyundai group. Among the top four *chaebol*, Hyundai was the only one not organically tied to the Roh regime. While Samsung maintained intimate connections with the TK mafia (Taegu–Kyungbuk regional/school connection), the mainstay of the regime, Daewoo, was protected by the SK mafia (old school ties involving Seoul National University and Kyunggi Senior High School) that constitutes the core of the public bureaucracy. As noted before, Sunkyung was tied to President Roh by marriage. Hyundai had been left out. To survive under this setting, Chung ventured into independent political action.

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6 The Dynamics of Business–Government Relations in Industrialising Malaysia

Alasdair Bowie

Overshadowed by 'economic miracles' in the Northeast Asian newly industrialising countries as well as in neighbouring Thailand, Malaysia's transformation from a producer of raw materials to a manufacturer of sophisticated industrial goods and the world's third-largest exporter of semiconductors (after Japan and the United States) has long gone unrecognised. Yet Malaysia has had few peers in the developing world in its ability to develop economically while preserving political stability under conditions of sharp ethnic polarisation.

Since the early 1960s, Malaysia has recorded economic growth rates that have consistently outperformed the average for all middle- and lower-middle-income countries. Over the twenty-five years ending in 1980, real GDP increased at an average annual rate of 7.4 per cent; in the decade 1980–90, the average was 5.2 per cent; and for the five years 1987–91, 8.3 per cent (World Bank 1992a: 220–21, 1992b: 23; Malaysia 1991b: xiv–xv). Accompanying this growth has been sweeping change in the structure of the Malaysian economy: agricultural commodities and minerals (rubber and tin, for example) have declined in relative importance, being displaced by manufactures (particularly electrical and electronic products) which accounted for an estimated 64 per cent of exports in 1991. The manufacturing sector, growing in real terms at an annual rate of 15.5 per cent in 1991, has supplanted all other non-service sectors as the leading contributor to GDP, accounting for an estimated 29 per cent of the total in 1991, compared with 17 per cent for agriculture (including forestry and fishing) (Malaysia 1991b: xv, 7–9).

The pace and direction of this transformation reflect evolving relations between government and private sector business in Malaysia. This chapter describes the nature of this relationship, how it has evolved over time, the role the government has had in shaping it, and how it has affected political and economic outcomes that have provided the underpinnings for Malaysia's economic 'take-off'.

SOME HISTORICAL BACKGROUND

Formerly a British colony, Malaysia straddles the Malay Peninsula—from the border with Thailand to Singapore—and the northwestern third of the island of Borneo (which it shares with Indonesia). Its more than eighteen million people consist of three main ethnic communities: indigenous *bumiputras*, most of whom are ethnic Malays (accounting for about 48 per cent of the population); and sizeable immigrant communities of Chinese (36 per cent) and Indians (9 per cent) (Neher 1991: 103). Malays, descendant from migrants from Central Asia, are concentrated in rural areas but are also found in large numbers in urban areas and in commercial settings. The Chinese came as traders or, in the 19th century, as tin miners, and their descendants are most numerous in the towns and cities where they still dominate locally owned commerce and small scale industry. Indians were imported from South India by British plantation interests to work sprawling estates during the rubber boom of the turn of the century. The Indian community today includes, in addition, descendants of Punjabi traders, businessmen and professionals who migrated in the years following the First World War. They contributed to what is a substantial permanent population comprising, as is the case with the two other main ethnic groups, a mixture of rich and poor, worker and employer, rural and urban dweller.

The economy of newly independent Malaysia in 1957 had many of the weaknesses characteristic of new states of that era: it was raw material dependent, it was foreign (mainly British) dominated, it produced a limited range of exports, and it was dualistic in both rural/urban and native-born/non-native-born senses (Bowie 1991: 68). In the intervening thirty-five years, considerable progress has been made in overcoming these weaknesses; today nearly 60 per cent of Malaysia's exports are manufactures. Nevertheless, as an oil producer, Malaysia still earns substantial revenues from oil and natural gas; and commodity exports remain important although more diversified than before, with such goods as palm oil and cocoa overshadowing rubber and tin.

Since independence, politics in Malaysia has been dominated by the United Malays National Organisation (UMNO), a Malay ethnic party which has led to victory in all eight general elections a multi-party, multi-ethnic coalition, the Barisan Nasional (National Front).

The two other main constituent parties are the Malaysian Chinese Association (MCA) and the Malaysian Indian Congress (MIC). The Barisan originated with British conditions for the granting of independence which included demands that the new government be truly representative of all communities. It has been sustained by an informal intercommunal pact, or 'settlement' of the ethnic question, by which the ethnic elites have agreed that the largest group, the Malays, should dominate government. Thus UMNO is the leading coalition party and dominates the cabinet; Malays have predominated in the bureaucracy; and the head of state, the King, is elected by the rulers of the nine traditional Malay royal families. In return, the immigrant Chinese and Indian communities were granted full citizenship rights and protection from ethnically motivated official interference in their economic or cultural affairs.

Malaysia's is a Westminster-style, two-chamber parliamentary democracy under a constitutional monarchy. However, in a departure from Westminster, the prime minister—the leader of UMNO—has amassed considerable executive authority with a powerful Prime Minister's Department and ability to amend the constitution at will (due to the Barisan's two-thirds majority in the lower house). Parliament, in most respects a rubber stamp, is nevertheless an important vehicle for the airing of opposition views, and its composition is viewed as an important gauge of Barisan support. Both periodic by-elections and the five-yearly general elections are thus vigorously contested. The eleven states each have their own elective bicameral state governments, but the predominant weight of state power rests with the federal executive branch in the capital, Kuala Lumpur.

At independence, the new government faced the policy challenge of developing a strategy to encourage industrial expansion—thereby reducing commodity dependence—while at the same time trying to raise the standard of living of the predominantly rural population. Malaya was fortunate in many respects; as noted in a 1955 World Bank report, British efforts to provide access to exploitable natural resources and to isolate communist guerrillas during the Malayan Emergency of the 1950s had left a legacy of relatively well-developed infrastructure services, and in addition the British left intact a relatively functional public administration (World Bank 1955: 13).

During most of the first decade, the resources of this administration were directed to meeting the needs of rural dwellers and increasing and diversifying agricultural output. Political concerns were paramount. By spending heavily on agriculture, UMNO sought to secure the electoral allegiance of the mostly rural Malay community. Industry was slow to develop and left to the private sector (still largely in foreign hands), with some general tax relief and infrastructure development offered as incentives (Bowie 1991: 69–74).

Politics played a role here, too. Chinese—and to a lesser extent Indian—dominance of domestically owned business discouraged government measures which, while favourable to domestic business, might have been viewed by Malay voters as reinforcing non-Malay economic dominance. Some policies were enacted to foster increased Malay entrepreneurship but these tended to be piecemeal and ad hoc, tempered by a government commitment at the time to market-based solutions to economic problems. New foreign investment was viewed as the most desirable vehicle for expanding manufacturing and was therefore the main intended beneficiary of measures such as the setting up of industrial estates and 'pioneer industries' tax relief. Most of the investment that focused on import-substituting industry was foreign rather than domestic in origin. But new foreign investment was generally scarce in Asia in the 1960s, and Malaya was viewed as especially risky by investors as a result of the communist emergency (1948–60) and Indonesian assaults during a 'confrontation' in 1963 (Mackie 1986: 7; Hing 1984: 304). So, while existing investment in plantations and mining remained, new investment in manufacturing and industry was slow in coming.

BUSINESS–GOVERNMENT RELATIONS IN THE 1970s

On 13 May 1969, race riots broke out in Kuala Lumpur in the aftermath of a general election in which Chinese and opposition parties appeared to have made significant electoral gains at the expense of the Malay-dominated governing coalition. The violence of this response to the apparent electoral ascendancy of opposition Chinese ethnic parties reflected deeper malaise within Malaysian society. Frustrated and anxious at the lack of Malay advancement and at the growing electoral strength of the Chinese, many Malays rejected the informal inter-elite 'settlement' of the ethnic question adopted in 1957, and sought a more explicitly pro-Malay solution to the problem of inter-ethnic economic inequalities.

May 13 was a watershed in relations between government and business in Malaysia. (This analysis of politics and business in the 1970s draws on Bowie 1991: 82–110.) In the months that followed, Malay political leaders rescinded their earlier implicit commitment not to use the power of the state apparatus to wring concessions from non-Malay business. Abandoning the non-interventionist policy of the previous decade, the UMNO leadership introduced a new regime involving extensive state regulation of private sector economic activity, with the explicit objective of stimulating increased Malay economic participation. Simultaneously, they authorised the use of numerous state sector corporations (some of which had existed previously) as proxies for Malay economic enterprise, until such time as Malay entrepreneurs could compete on equal terms with non-Malay business. Although private sector business was still free to choose what goods and markets to pursue, the state now sought to influence private sector employment and investment decisions in order to encourage the hiring of Malays and the granting of business partnerships to Malay investors. Business, which domestically was almost exclusively the domain of non-Malays, saw this new state of affairs as unacceptable because it impinged upon assumed freedoms to conduct commerce unimpeded by burdensome state regulation. However, private sector resistance to these state initiatives served only to precipitate more aggressive state action on behalf of the Malay community.

The government's principal response to the riots was adoption of the New Economic Policy (NEP), which explicitly sought to redistribute wealth and economic activity from non-Malays to Malays within the context of an expanding economic 'pie'. Thenceforth, improvement in the economic well-being of the 'have nots' in Malaysian society—meaning the Malays—was to be the focus of state development efforts aimed at:

> . . . accelerating the process of restructuring Malaysian society to correct economic imbalance, so as to reduce and eventually eliminate the identification of race with economic function. This process involves . . . the creation of a Malay commercial and industrial community in all categories and at all levels of operation, so that Malays and other indigenous people will become full partners in all aspects of the economic life of the nation (Malaysia 1971: 1).

The NEP represented a form of Third World economic nationalism, but here the principal antagonist was not foreign but rather domestic—the non-Malay businessman whose decisions were believed to have adversely affected the prospects for Malay advancement. Business thenceforth was subject to government measures designed to elevate the economic status of the politically dominant Malay community. At the same time the government undertook to economically empower the Malay community by fostering Malay entrepreneurship. The government established programs to help Malay entrepreneurs by providing the skills and inculcating the attitudes necessary to compete in a modern industrial economy and, in addition, government agencies provided nascent Malay business with start-up capital. Malay business was provided with the finance and expertise necessary to get off the ground (Milne & Mauzy 1980: 321, 325).

The NEP established specific targets for Malay shares in employment and ownership in the industrial sector:

> Within two decades at least 30% of the total commercial and industrial activities in all categories and scales of operation should have participation by Malays and other indigenous people in terms of ownership and management. (Malaysia 1971: 158)

Associated with the NEP was a broad reorientation of government economic policy in the 1970s toward promotion of commercial and industrial expansion and this had considerable sectoral impact: by 1975, the industrial sector had more than doubled its share of GDP over the level for 1961 (17 per cent versus 8 per cent) (Milne & Mauzy 1980: 328). Industrial change was no longer to be the product primarily of aggregated private sector business decisions. The government at this point overlaid an earlier market-led 'strategy' with a new strategy embodying unprecedented levels of direct government intervention to achieve redistributive goals. Initially, this took the form of substantially increased allocations for industrial development in the government's development budget and attempts by government leaders to cajole business into changing its practices to accommodate Malays. When this failed—most non-Malay employers resisted hiring Malays (often claiming they were inexperienced and not well motivated)—the state imposed increasingly intrusive regulation on private business. Any firm seeking state support (e.g. participation in tax relief programs, or protection from imports) had to undertake to employ at least 30 per cent Malays at all levels. A proportion of licences and government contracts were also reserved for Malays and Malay-owned firms (Puthucheary 1978: 107; Milne & Mauzy 1980: 331, 334, 338).

The state also adopted a higher profile as an economic actor in its own right, embracing a policy of 'participat[ing] more directly in the establishment and operation of a wide range of productive enterprises through wholly owned enterprises and joint ventures with the private sector' (Malaysia 1971: 7). It established numerous new public corporations and extended the range of operations of existing ones in an attempt to create proxies for Malay business that would eventually be converted to private (Malay) ownership (Puthucheary 1978: 107; Milne & Mauzy 1980: 336). Over the five-year period ending in 1975, development budget allocations for government corporations involved in commerce, industry and tourism were more than ten times those of the previous five-year period (Malaysia 1971: 180; 1976: 323).

By 1975, the Malay share of manufacturing jobs had increased to 32 per cent, from 25 per cent in 1970. Malays comprised 17 per cent of managers (compared with 11 per cent in 1971), according to a private survey. Malays held almost 30 per cent of institutional credit, up from 14 per cent in 1971, and Malay ownership of all capital stood at 8 per cent (Malaysia 1976: 31; *Southeast Asia Chronicle* 1980; Milne & Mauzy 1980: 406).

Nevertheless the slow pace of this change under the NEP was a source of frustration, both to the UMNO leadership and to non-Malay business. Certainly Malay entrepreneurs were becoming more numerous than in the 1960s, but in many cases their activities were limited to rent-seeking partnerships which afforded non-Malay partners access to Malay quotas but rarely provided Malay partners with hands-on management experience (Milne & Mauzy 1980: 335). Thus increasing economic opportunity for Malays under the NEP did not necessarily translate into increased entrepreneurial acumen or competitiveness with non-Malay business. Moreover, filling the 30 per cent target for Malays in management was proving difficult because of a shortage of experienced Malay managers.

The government responded in 1975 by passing the *Industrial Co-ordination Act* (ICA) which created a system of licences for industry and made issuance of such licences conditional upon compliance with NEP guidelines. The primary target was Chinese business which, for the most part, continued to use family-based employment and ownership practices which effectively precluded Malay participation. Different segments of this community responded in different ways: the larger and more established sought partnership with Malays or used informal means or personal ties to circumvent the restrictions; others, apprehensive over the implementation of the licensing scheme and concerned at the likely inflexibility and ethnic chauvinism of Malay civil servants, tended to redirect their investment toward non-productive uses, such as real estate or financial instruments (*Southeast Asia Chronicle* 1980). This, combined with the influence of a world recession at the time, precipitated a marked decline in productive investment, about 60 per cent of which was attributable to domestic—mainly Chinese—investors (Halim 1990: 73). Domestic private investment in commercial and industrial enterprise in 1977, for example, fell well short of the M$22 billion target projected for that year by the Third Malaysia Plan (diplomatic source dated 28 September 1977).

Lagging domestic investment prompted the state to court foreign investment more vigorously. However, the ICA caused unease not just for domestic investors but also for potential foreign investors already hesitant to commit to the region because of international developments at the time, including a slump in world trade in the wake of the first oil shock and regional instability following the communist victories in Indochina. Such hesitancy was reinforced in the Malaysian case by the earlier adoption of the *Petroleum Development (Amendment) Act* which threatened nationalisation of foreign-owned oil exploration and production facilities (Milne & Mauzy 1980: 348). Despite stepped-up measures to lure foreign investors—including 'one stop' investment approval at the Malaysian Industrial Development Authority (MIDA), expansion of incentives for export production (associated with free trade zones, industrial estates and licensed manufacturing warehouses) and use of labour laws to exclude unions from key export industries such as electronics—foreign investment in 1976 grew by a mere 3 per cent, not the targeted 10 per cent (Milne & Mauzy 1980: 409; Wong 1990: 108; Tan 1983: 65–6, 68, 73; *WSJ*, 22 September 1975: 24).

The shortfall in private (domestic and foreign) investment led the government to moderate its stance on redistribution and to amend the ICA to expand the range of businesses exempt from the Act's requirements. The government also took up some of the slack itself: statutory bodies began investing in private corporate stock offerings that were by law reserved for Malays (these represented a minority of each public offering). The scale of government holdings of corporate stock rapidly exceeded that originally envisioned when such bodies were created in the 1960s. State intervention also extended to activities of the ruling party: UMNO created its own corporate vehicle (the Fleet Group of companies) and began accumulating stock from Malay share issues and taking advantage of ownership quotas to develop its own stable of companies (*AWSJW*, 24 December 1990: 10). This rapid accumulation of wealth in the hands of state and party institutions, the burgeoning scale of public bodies like PERNAS (Perbadanan Nasional: the 'National Corporation') and the political implications of UMNO economic participation all exacerbated the anxiety already felt by non-Malay business and further discouraged long-term private domestic investment (David Lim 1986: 160).

Summarising government–business relations in the 1970s in comparison with patterns characteristic of the 1960s, one observes a change in government priorities: away from rural towards commercial and industrial development; away from a relatively even-handed treatment of business, regardless of ethnicity, towards the explicit favouring of Malay business; away from a relatively laissez-faire approach to industrial development towards one which exerted strong pressure on private sector business to meet government employment and ownership quotas for Malays; and away from a rather passive state towards one actively involved in capital accumulation through a wide range of both state and party enterprises, often in direct competition with the private sector.

The goals of the NEP were not met in the 1970s although considerable progress towards them was indeed achieved. State regulation of business hiring and ownership to give Malays more economic power appeared inadequate to satisfy rapidly rising Malay aspirations. Even under the ICA, Chinese and Indian business appeared entrenched and capable of protecting its economic position against Malay demands for a 'fair' share of the economic wealth of their country. Foreign-owned business, while contributing to industrial expansion in general, also seemed to offer comparatively little to the Malay community. Foreign firms in free trade zones, for example, absorbed only limited quantities of local materials—in general, less than 5 per cent of value-added—and established few linkages with the local economy beyond employment of low wage labour (Warr 1987: 189–94; Wong 1990: 113; Chee 1987).

Meanwhile, Malaysian industry as a whole remained narrowly based, with few backward or forward linkages and an excessive reliance on electronics and textiles for much of its dynamism; it grew at just 3.25 per cent annually between 1980 and 1982. Only wood-based and electronic and electrical goods industries were judged to have favourable future prospects. Large scale, capital-intensive industry was almost non-existent in the Malaysian economy at the time (Kanapathy 1981: 10). As MIDA Chairman Tan Sri Jamil Jan observed: 'It will be difficult for us to maintain a rapid pace of development unless we set up some of the heavy industries ourselves. These industries are not only necessary but also feasible and viable' (*Asian Finance*, 15 October 1981: 81).

STATE-LED INDUSTRIAL DEEPENING IN THE 1980s

Ultimately, the relative balance of government and business interests achieved during the 1970s in Malaysia failed to satisfy the respective participants. In response, the Minister of Trade and Industry Dr Mahathir Mohamad in November 1980 announced a policy initiative which was to have the effect of reshaping government–business relations for most of the following decade (Bowie 1991: 111–52). Its stated objectives were:

> . . . reduc[ing] the [country's] dependence on foreign countries for the supply of machinery and intermediate inputs, exploit[ing] forward and backward linkages in industrial development, creat[ing] spin-off effects for the growth of small and medium-scale industries, and develop[ing] the technological capability of the manufacturing sector. (Malaysia 1984: 250)

Placing state-run enterprises in the vanguard of a state-led industrial deepening effort, the heavy industries policy aimed to create a completely new stratum of capital-intensive (i.e. 'second stage') and import-substituting industries to provide the underpinnings for new private sector intermediate and consumer goods industries (Pura 1983: 380).

Mahathir explicitly pointed to the Japanese and South Korean 'economic miracles' as exemplars for what he sought to achieve using the heavy industries policy in Malaysia. His perception of Malaysia's earlier experience of industrialisation was central to the form the new strategy took. He was convinced that domestic business was unable (or unwilling) to undertake large scale projects with heavy capital requirements and long gestation periods. With high regard for the capabilities of state-led enterprises and suspicion of private sector industrial abilities, Mahathir embraced the South Korean import-substituting, export-promoting 'model'. South Korea appealed perhaps not simply because of its industrial record but also because it was the only NIC whose people were not ethnically Chinese. Championing a non-Chinese exemplar thus enabled Mahathir to embrace a NIC 'model' while avoiding the charge that he was perpetuating the unacceptable domestic economic dominance of the Malaysian Chinese (Jomo 1986: 2). State-led industrial deepening was attractive to the Malay leadership because it suggested a leading role for the Malay-dominated civil service.

There were also political considerations. As one senior official observed: 'The projects we're going into aren't purely economic projects. They have quasi-political, economic and strategic considerations' (Pura 1983: 380). Under pressure from some sections of the Malay community to more aggressively pursue NEP goals using direct state action, Mahathir and the UMNO leadership found in the heavy industries policy an attractive vehicle by which to hasten the redistribution of economic power as envisioned in the NEP. As another observer said:

> The government's involvement in the projects will help Kuala Lumpur meet its New Economic Policy goal of restructuring the national economy to increase the participation of Malaysia's bumiputras, or indigenous ethnic groups. The government-sponsored plants—notably the car, cement and steel plants—will erode the domination of ethnic Chinese entrepreneurs in those industries and serve as training grounds for a new class of bumiputra industrial manager and skilled blue-collar workers. (Pura 1983: 380)

The scale of the heavy industries projects also reflected ethnic political considerations. Existing small and medium scale domestic industry was primarily in the hands of Chinese business and it made little sense politically to favour them when the Malay community was already anxious about the slow rate at which it was catching up to the non-Malays (Halim 1990: 74).

The heavy industries policy thus became a vehicle for simultaneously achieving two not very compatible objectives: an economic goal, of accelerating the pace of industrialisation; and a social and political one, of redistributing national income to help the Malays who were the group least active in the industrial sector. Its centrepiece was the state-owned Heavy Industries Corporation of Malaysia (HICOM), chartered 'to plan, identify, initiate, invest [in], implement and manage projects in the field of heavy industries'. (Malaysia (HICOM) 1985: 10). HICOM undertook a series of joint ventures with foreign partners in iron and steel, cement, automobiles and small internal combustion engines. It had the support of state development expenditures in the first five years (1981–86) estimated at between six and eight billion Malaysian dollars, or the equivalent of the allocation for all social programs (which totalled M$6.4 billion) (Malaysia 1981: 242). In autos, Malaysia's 'national car', the Proton Saga, was heavily promoted as an example of what Malaysians could achieve in the industrial realm, given state leadership and foreign technology (in this case, that of Mitsubishi). On the East Coast, natural gas reserves discovered in the early 1970s were tapped to fire a M$1.2 billion iron and steel plant, completed in 1985 (*AY* 1988: 182; Malaysia (HICOM) 1985: 16; Mukerjee 1986: 82; Halim 1990: 85, n. 30). HICOM commissioned a major new cement plant on an island off the west coast state of Kedah. And in small engine manufacture (up to 200 cc), HICOM undertook ventures with partners Honda, Suzuki and Yamaha, each involving a thirty per cent HICOM share in investments in the M$8–10 million range (Malaysia (HICOM) 1985: 18). The heavy industries policy was also associated with a number of energy refining and utilising projects, two of the largest being the ASEAN/Malaysia ammonia–urea fertiliser project in Sarawak and production facilities for the processing and export of natural gas, both built by the state-owned oil company, Petronas (*FEER*, 26 October 1989: 116–18; 9 February 1989: 53).

Mahathir's anticipated industrial 'take-off' was slow in coming, however. Economic conditions in Malaysia during the 1980s were not generally favourable to the success of the HICOM heavy industries. A slowing world economy in the early 1980s depressed prices for Malaysia's major commodities to their lowest levels in thirty years. Subsequent improvement in 1984 and early 1985 gave way to an even more debilitating commodities slump, the worst in the country's post-colonial history, that resulted in contraction of the domestic economy in 1985 and 1986 (real GDP fell 1 per cent in 1985 and grew just 1.2 per cent in 1986) just as the first heavy industries began producing (Malaysia, Ministry of Finance, 1991b: xiv–xv).

With virtually every major HICOM unit in the red, from its auto-making division (Proton) to its steel subsidiary (Perwaja Trengganu) and its cement operation (Kedah Cement), the corporation suffered operating losses for the 1986–87 year of M$249.6 million (US$100 million)—an increase of 71 per cent over the previous year—and after tax losses of M$117.8 million (US$47.3 million) (*AWSJW*, 28 December 1987: 14; *FEER*, 1 September 1988: 56). Besides these losses, extensive foreign debts incurred by the state enterprises further drained state coffers. At the end of 1988, federal government liabilities stood at M$5.5 billion (US$2.2 billion), of which two-thirds or M$3.7 billion (US$1.5 billion), took the form of contingent liabilities stemming from government-backed foreign loans. Thirty-seven per cent, or M$15.3 billion (US$6.1 billion) of the total public sector debt of M$41.6 billion (US$16.7 billion), was attributable to these public enterprise loans (*AY* 1988: 182).

The changed external environment—namely the international commodity price slump of 1985 and 1986—that had prejudiced the domestic future of Malaysia's new state-led heavy industries now precipitated a change in policy towards these industries. The government needed to act to prevent them dragging down the economy as a whole.

PROFITS, PRIVATISATION AND THE PRIVATE SECTOR

By mid-1988, it became clear that the cabinet had abandoned its eight-year commitment to the vanguard role of state (and Malay) management of the heavy industries. Vilification of existing management followed, Malay Finance Minister Daim characterising the (Malay) civil servants involved as ineffective and—asked whether he thought it had been a mistake to expect civil servants to be able to run large scale industries successfully—observing: 'Some are good . . . one or two' (*FEER*, 7 July 1988: 97). Citing heavy losses and mismanagement, cabinet ministers, including Mahathir himself, now downplayed Malay advancement and the fostering of a Malay business class as the guiding lights for the heavy industries (i.e. the social change rhetoric of 1980–81). Their 'watchwords' now became markets, profitability and exports (Halim 1990: 77).

Within months, management of state industries passed to private sector managers, in most cases executives of foreign joint venture partners, and almost without exception non-Malay, something quite unthinkable in the early days of the NEP (Halim 1990: 77). Malay managers of the major HICOM subsidiaries quickly found themselves supplanted by non-Malays. In fact, within twenty-four hours of Daim's August 1988 speech signalling the change, Proton's deputy chairman resigned and the executive director soon followed, to be replaced, at the request of the prime minister, by executives of Mitsubishi. Kenji Iwabuchi, former managing director of Mitsubishi Motors, became Executive Director, and Kyo Fujioka, another Mitsubishi manager, was named head of the division for corporate planning. HICOM's steel-making subsidiary, Perwaja Trengganu, was passed from Malay Director and General Manager Haji Razali Haji Ismail to Eric Chia, a private sector magnate who is ethnic Chinese and who controls the Toyota franchise in Malaysia, United Motor Works. Meanwhile, another Malaysian Chinese entrepreneur Heng Keah Yong was named manager of HICOM's 35 per cent owned Kedah Cement (*FEER*, 1 September 1988: 56; *The Star*, 31 July 1991: bus. 1).

These management changes at HICOM were both economically and politically consequential. Economically, they indicated a new government emphasis on market signals and the profit criterion for evaluating state enterprise performance. The government was prepared to pass management (if not equity) control over state industries not just to non-Malays but to foreigners if necessary, if that would ensure the profitability of potentially embarrassing white elephants. Politically, the surrender of prestige government projects to Japanese and local Chinese business interests suggested a slap in the face for ethnic Malay pride and a downgrading of NEP redistributive objectives (*FEER*, 1 September 1988: 56).

HICOM management changes are by no means the only steps that have been taken since 1988 to reorient government industrial policy away from the earlier commitment to state-led industrialisation. Privatisation and rationalisation have become prominent themes among government announcements. For example, in 1988 Finance Minister Daim announced a list of sixty public enterprises which the government was evaluating, to determine whether they should be 'closed down, rehabilitated or privatised.' And, in early 1989, HICOM's steel-making subsidiary and perpetual loss-maker, Perwaja Trengganu, was 'privatised' in a bailout involving its sale to Ministry of Finance Incorporated, a private company wholly owned by the ministry (*FEER*, 22 June 1989: 53).

Since 1988, recovery in the economy has prompted a modest revival in sales and profits at HICOM. Proton, under Kenji Iwabuchi, for example, has nearly quadrupled its production rate, from 24 345 cars in 1988 to 88 000 in 1991; increased its capacity to 100 000 units; captured domestic market share of 72 per cent (cars of under 1600 cc); and increased its exports from an annual 2850 in early 1989 to 34 000 as of June 1991. In July 1991, it opened an engine and transmission factory enabling it to substantially increase the local content of its cars. Proton finally eliminated its accumulated losses in 1990 and made a profit for the year ending 31 March 1991 of M$261 million (US$97 million). HICOM's group profits were M$478 million (US$177 million), and its combined retained profits and paid-up capital for the first time just about equalled its debt of M$600 million (US$222 million) (*The Star*, 31 July 1991: bus. 1; *Bangkok Post*, 18 July 1991: 21; *New Straits Times*, 3 August 1991: 1).

This turnaround in HICOM's fortunes has not sparked a resurgence in state-led conceptions of industrial change. On the contrary, Proton's good showing has prompted the government to consider capitalising on its sunk investment by privatising part of the state's 70 per cent stake in the subsidiary by means of a public stock issue (*The Star*, 31 July 1991: bus. 1). Now that private sector industrialisation is the focus of government policy, Malaysia is actively seeking foreign participation as the principal vehicle for rapidly expanding capital- and technology-intensive industries and increasing manufactured exports. A variety of liberalisation measures, such as laws to limit the ability of national labour unions to press for higher wages and improved employee working conditions, are specifically designed to attract foreign investors.

With increasing numbers of Japanese companies investing in Malaysia in the late 1980s, the government moved to overhaul Malaysian labour laws to encourage Japanese-style enterprise unions and weaken existing large national unions. This move was also a response to labour actions in 1990 that included stoppages at US-owned Harris Solid State Electronics and a strike at Hitachi Consumer Products that resulted in the firing and selective rehiring of 800 workers (*FEER*, 1 November 1990: 64). Such actions threatened Malaysia's reputation as an export base with a well-educated, compliant but relatively low wage workforce. They prompted amendment of the *Trade Union Act*, the principal legislation governing industrial relations, in March 1989, to permit registration of enterprise unions, and to allow such unions for the first time in the electronics industry. This represented a compromise of sorts, as existing unions have been forced to accept enterprise unions in industries where they will compete with national unions for members (Halim 1990: 75–6).

The government has also relaxed conditions for foreign investors by raising the threshold above which Malay equity and employment requirements take effect. As amended in October 1986, the Industrial Co-ordination Act applies only to those ventures with shareholder funds exceeding M$2.5 million (up from M$1 million) or employing 75 or more full-time employees (Halim 1990: 73). Limitations on the number of expatriate employees and domestic equity requirements applying to foreign companies seeking manufacturing licences have also been eased. It is now possible for the foreign investor to hold 70 per cent of an export-oriented business that sells at least 50 per cent of its output to factories in free trade zones and employs at least 350 full-time Malaysian workers (or up to 100 per cent in the case of a venture exporting at least 50 per cent of its output) (Halim 1990: 82, n. 28; Nathan 1989: 136–7; *FEER*, 4 May 1989: 81; *AWSJW*, 3 July 1989: 21). Moreover, the *Promotion of Investments Act 1986* expanded the incentives available to the foreign investor, and subsequently the government has increased its provision of short-term export credits to enhance the international competitiveness of export products manufactured in Malaysia (Malaysia (MIDA) 1991a: 11–28). Tax rates on corporate profits were lowered in 1989 (the highest reduced from 40 per cent to 35 per cent), a 5 per cent development tax on company profits was rescinded, and in 1990 tariffs were reduced across the board but especially on business equipment, as part of a government commitment to reduction of the high cost of inputs associated with protected domestic manufacturers (Nathan 1989: 136–7; *FEER*, 4 May 1989: 81; *AWSJW*, 3 July 1989: 21; 24 December 1990: 4).

Government industrial policy since 1986 has thus focused on exports and the attracting of export-oriented foreign investors, but with continued protection of domestic intermediate goods industries such as the HICOM joint ventures. From a comparative perspective, this strategy bears some similarity to the import-substituting, export-promoting policy employed in South Korea in the 1960s and 1970s. In the Malaysian case, it has been associated with an expanded flow of foreign investment into Malaysia, particularly since 1988. However, the trend in rising foreign investment is not limited to Malaysia. Both Thailand and Indonesia have also benefited. Therefore the rising levels of foreign investment may be attributed not only to the pull of incentives but also to externally generated 'push' factors associated with rising production costs in Japan, Taiwan and South Korea for example.

FROM STATE-LED TO PARTY-LED?

There is another aspect of state intervention in the Malaysian economy in the 1980s which has influenced the terms of private sector participation in economic activity and which warrants some attention here. This is the erection of a corporate empire blessed with unrestricted access to state-issued licences and Malay preferences that is under the direct control of the governing party, UMNO, and is used to raise funds for constituent and electoral purposes. Government leaders have used Malay preferences from the NEP to justify the awarding of contracts to UMNO-linked enterprises and individuals, creating in the process a large and influential group of domestic, *bumiputra* companies that are in fact the vehicles for ensuring continued UMNO political dominance. This development is best illustrated by the government's awarding of a M$2.3 billion contract in 1987 for the country's largest public works project to date, the 960 kilometre North–South Highway from Singapore to Thailand, to United Engineers (Malaysia) Berhad (UEM). UEM had never actually built a road, and had a dismal record in other areas. The crucial qualification which UEM did possess, however, was that it was controlled by UMNO. The contract promises to be enormously lucrative for UEM and UMNO because it grants the contractor the right to operate the country's most important highway as a toll road, and to benefit from a rather generous formula for toll revenue sharing with the state (*AWSJW*, 24 December 1990: 10).

This use of discretionary powers to allocate a major contract to a ruling party front company had few precedents and raised a storm of criticism. The government justified its actions with reference to the NEP—as UEM was controlled by Hatibudi, a *bumiputra* company—and praised the contract as a privatisation milestone as the highway would be built not by the government itself but by a private company. The clear winner was UMNO. Some observers speculated that UEM received the contract so that profits from tolls would help pay for UMNO's heavily indebted party headquarters, the World Trade Centre skyscraper in Kuala Lumpur (*AWSJW*, 24 December 1990: 10).

UMNO has used its control over companies for political purposes in the past, a case in point being its control over print media using the Fleet companies (including the largest circulating English language daily, the *New Straits Times*). But the granting of the highway contract to an UMNO-linked company under the umbrella of Renong, currently the main UMNO holding company, was unprecedented in its scale, audacity and wider implications.

The case has had an important impact on business perceptions of the overlap of state and market in Malaysia. It suggests that such contracts are accessible only with forfeiture of partnership—and profit—shares to party-sponsored companies (interview, Kuala

Lumpur, August 1991). This is not always the case, as British Gas learned in August 1991 when it sought to partner UEM in a bid to participate in Malaysia's M$800 million (US$293 million) natural gas distribution project, but was passed over by Petronas in favour of bids by two Japanese companies in partnership with a local company controlled by government-owned investment trusts (*FEER*, 17 October 1991: 110). Nevertheless, granting UEM a large number of government 'privatisation' contracts, including most recently the contract to build the second causeway between Malaysia and Singapore, suggests a blurring of government and party interests (*FEER*, 17 October 1991: 110). In fact, the process may already be well advanced; it has been estimated that government/party control through trust agencies and other means amounts to effective dominance in the mining, plantation and finance industries, and is expanding in both construction and the media (*AWSJW*, 24 December 1990: 10).

This blurring of government and party has also caused distortions in other sectors of the economy. Malaysia's second-largest (sometime largest) bank, state-owned Bank Bumiputra (Malaysia) Berhad (BBMB) (*AWSJW*, 21 January 1991: 15), established in 1965 to provide credit for *bumiputras* denied access to credit elsewhere, is hobbled by its role as lender of last resort for much of *bumiputra* business. In 1985, the bank was rescued by a Petronas buyout from loan losses totalling M$2.26 billion (US$1 billion) linked to questionable real estate lending by a Hong Kong subsidiary. Petronas again came to the rescue in 1989 when a loss of M$1.06 billion (US$393 million) wiped out the bank's paid-up capital, and necessitated an infusion of M$982 million (US$364 million). In its involuntary service as BBMB's holding company and frequent saviour, Petronas has lost an estimated M$1 billion (US$370 million) (*AWSJW*, 21 January 1991: 15).

BBMB's losses stem primarily from unsound banking practices associated with nonperforming loans. The bank has a dismal lending record and weak financial and credit controls linked to pressure from political sources, which senior management is in no position to resist, to make questionable loans to politically well-connected concerns and individuals (*AWSJW*, 21 January 1991: 15). This means that an UMNO company, or an individual with close ties to a leading UMNO figure, can expect cursory approval procedures when requesting from BBMB a loan that elsewhere might have little chance of approval. The costs of this shadowy and poorly documented flow of state resources into private hands are reflected only indirectly in Petronas and BBMB balance sheets. Nevertheless, they contribute to an undermining of the financial stability of one of the country's largest banks and hence of the Malaysian banking sector as a whole.

The increasingly porous interpretation of limits to ruling party interests has been accompanied by a politics that is becoming progressively more exclusionary. While UMNO has employed NEP redistributive goals as a blanket rationale for the awarding of government contracts to UMNO-linked enterprises, attempts to exclude dissenting groups and factions in politics have been justified in terms of the need for a strong executive state unfettered by the nitpicking of an independent judiciary or a hostile opposition.

This exclusionary trend is related to political factionalism within UMNO following the 1985–86 recession. Tied not to the political needs of a new industrial stage (as bureaucratic authoritarian state theorists might have it) but to the indirect effects of an external economic shock—a commodity price slump—an unprecedented rift emerged in Malay politics in 1987. Mahathir's confrontational leadership style and the alleged use of government development policies to benefit leading politicians and their 'cronies' were the oft-cited reasons. While these issues were indeed real, it is unlikely that they could have precipitated the upheaval witnessed in Malay politics had not adverse external conditions affected the ability of party leaders to placate opponents and shore up support by distributing patronage on the accustomed scale. Dissident groups had emerged within UMNO before (Mahathir had himself been dubbed an UMNO 'young Turk' in the 1960s), but their differences with party leaders were usually resolved behind closed doors after each party election. This was the first occasion on which a faction, having marshalled the support of a substantial minority of the party (close to 50 per cent), refused to accede to repeated calls for party unity.

Rebuffed in a hotly contested UMNO party presidential election which the prime minister won by a bare 43 votes, the dissidents, led by a former finance minister, formed in 1989 a new Malay party, Semangat '46 (Spirit of '46, alluding to the date of UMNO's formation). Loosely allied with the main Islamic opposition party PAS (Parti Islam SeMalaysia), two smaller Malay parties and one Chinese opposition party, Semangat '46 then mounted a direct electoral challenge to the ruling coalition in the general election of October 1990. For the first time Malaysian voters were faced with a real choice between competing inter-ethnic alternatives (Nathan 1990: 212–13). In the event, voters rebuffed Semangat's challenge, returning the UMNO-led ruling coalition to power with over two-thirds of the seats in the 180-seat parliament (*AWSJW*, 24 December 1990: 4; Halim 1990: 80).

The rift in Malay politics remains. With many of its luminaries dropping out of sight or defected to UMNO, Semangat '46 appeared a lame duck to some but victories in two local mid-term elections in August 1991 have served notice that its challenge to UMNO is still alive (*FEER*, 5 September 1991: 22).

These intra-party splits, and the resulting political vulnerability felt by Mahathir and the surviving UMNO leadership, have encouraged vigorous efforts to still extra-party opposition and impose exclusionary politics at the national level. In October 1987, Mahathir resurrected the draconian *Internal Security Act* (ISA)—a vestige of British efforts to suppress communist insurgency in the 1950s that authorises detention without trial for an almost indefinite period—to detain some 130 people, including opposition MPs, party dissidents, state land scheme settlers and a wide spectrum of government critics ranging from environmentalists and unionists to Islamic fundamentalists. The government cited its fear of rioting similar to that of May 1969 and the need for political stability to avert capital flight as justifications for this clampdown on pluralist politics (Halim 1990: 80). Clearly, the arrests were part of Mahathir's political offensive against opponents to his leadership both inside and outside UMNO.

Then, arguing that 'in matters of national security and public order, it is clearly the executive which is the best authority to make evaluations of available information in order to decide on precautionary measures to be taken . . .', the government amended the *Internal Security Act* in 1989 to eliminate judicial review of ISA detentions (Nathan 1990: 215). This was followed by measures which precluded judicial review of executive decisions governing the administration and running of political parties (Halim 1990: 78). Rulings by the courts nullifying these changes on constitutional grounds were themselves overturned when the government used the Barisan's two-thirds majority to end, by constitutional amendment, judicial oversight in Malaysia. A series of attacks on the courts followed, culminating in the firing of the Lord President (the equivalent of the US Chief Justice) and of two other Supreme Court justices. In addition, news laws were changed to eliminate judicial review and give the executive blanket powers to control the media free of oversight (Halim 1990: 78; *The Star*, 14 December 1989: 1). Clearly, the practice of exclusion within the dominant party and the ruling coalition has had its analogue at the national level with the imposition of exclusionary measures affecting both relations within the state and the terms of political participation by opponents of the government. The evidence suggests that such political exclusion is ultimately but indirectly the product of the adverse external economic conditions prevailing in 1985 and 1986 which precipitated the near-disintegration of UMNO.

FOREIGN INVESTMENT AND ECONOMIC TAKE-OFF IN THE 1990s

The independent effect of these political upheavals on the economy since 1987 has been difficult to discern because they have occurred against a backdrop of rapid growth in foreign investment and sustained expansion in manufacturing over the past five years. This expansion, initially export-driven, has now spread to domestic demand and investment, with real private investment increasing at annual rates in excess of 30 per cent in 1989 and 1990. In the process, the manufacturing sector has led the economy, growing in real terms at an average annual rate of 14.9 per cent over the five-year period 1987–91. Manufactured exports have also expanded rapidly, accounting for an estimated 64 per cent of exports by 1991 (Malaysia 1990: xiii; 1991a: 20, 22; 1991b: 8–9).

These developments have certainly had their costs. Government policymakers have viewed with some disquiet the growing indications that Malaysia is not immune to the 'Bangkok disease'—smog, polluted water sources and transportation bottlenecks—and that the pace of development in Malaysia too is starting to overwhelm the country's existing infrastructure. For example, when Hitachi and several other Japanese semiconductor manufacturers complained about electricity shortages in 1990, the National Electricity Board revealed that its 1986 projections for growth in electricity demand underestimated the actual increase by 40 per cent (*FEER*, 1 November 1990: 66).

Nevertheless, the pace of industrial change in Malaysia has generally been seen in a positive light by both government and business. What have been the causes of the 'take-off' in manufacturing since 1987?

At the international level the evolution of global manufacturing, with a shift in emphasis away from the technologically more advanced regions, has stimulated manufacturers' interest in countries like Malaysia that offer cheaper land, labour and inputs (such as energy). New foreign investment in Malaysia—particularly from Japan, Taiwan, the US and Singapore—is heavily concentrated in the electronics and electrical equipment industries. Although export-oriented electronics manufacture was first undertaken in Malaysia in the late 1970s, the industry has really taken off only since 1987 when foreign interest skyrocketed (Wong 1990: 111). Among investors, US companies have been the leaders in transferring advanced technology—such as that used in the fabrication of silicon wafers—to Malaysia. Yet Malaysia still has a considerable way to go before becoming a fully integrated manufacturing site for semiconductors. Local demand for chips as inputs—for the manufacture of computers and related peripheral devices, for example—is constrained as yet by the relatively small size of these downstream industries (*FEER*, 1 November 1990: 66).

Given the opportunities for countries like Malaysia stemming from this global division of labour and international currency realignments associated with the 1985 Plaza Accords, what in particular has enabled Malaysia to capitalise on such opportunities and what has been the role of government in the process? The 'take-off' that has blessed Malaysia since 1986 reflects in part the government's achievements in liberalising burdensome regulations that threatened the country's relative attractiveness to investors, in attracting foreign capital in competition with other desirable investment sites and in promoting new industry that is export- rather than import-oriented.

While it is difficult to distinguish that part of new foreign investment responding to 'push' factors (originating in international currency realignments or rising input costs in the advanced economies) from that responding to the 'pull' of local incentives, it seems clear that Malaysia's increasingly liberal regulatory conditions since 1986 have played some part in increasing its attractiveness to foreign and domestic investors alike. This liberalisation, forced on Malaysia by the failure of the industrial deepening of the early 1980s and the shortfall in domestic investment by Malaysian Chinese business, has encompassed not just simplification of approval procedures for investors but also the granting of exemptions from the NEP *bumiputra* ownership requirements mentioned earlier. Moreover, by downplaying the importance of state-led industrial projects, such as those of HICOM, and switching attention to large scale infrastructure projects, the government has provided opportunities for foreign investment in infrastructure development.

In the manufacturing sector, the period since the onset of liberalisation has witnessed extraordinarily high levels of domestic as well as foreign investment in manufacturing, with approved investments through June 1991 increasing at an average annual rate of 76 per cent, from US$478 million in 1987 to an annualised US$3.9 billion in 1991 (MIDA; data not yet published). If liberalisation initiated or at least contributed to this interest, what then were the factors that contributed to liberalisation itself? The final section of this chapter focuses on the political underpinnings of the relationship between business and government over the years since 1986.

THE POLITICS OF ECONOMIC LIBERALISATION

Economic liberalisation in Malaysia was encouraged by the near ruin of an inward-looking heavy industries policy in 1985–86, when slumping international commodity prices precipitated recession in the domestic economy. During the recovery, Malaysia had little choice but to rely on foreign capital and cheap labour exports to sustain her industrial growth. This situation happily coincided with a search by foreign capital, particularly Japanese, Taiwanese and South Korean, for offshore investment platforms promising a well-developed infrastructure and an educated, compliant and low wage workforce.

Liberalisation has been feasible politically because the principal beneficiaries are foreigners and members of an expanding, mostly Malay business elite with symbiotic ties to the governing Malay party. For foreigners to benefit is no liability for an UMNO leadership whose nationalist rhetoric has historically tended to the ethnic rather than the xenophobic. Likewise, that rising Malays and UMNO-controlled companies should benefit is not problematic politically, as this bolsters the party's financial security and secures its political future while advancing the longstanding NEP goal of nurturing a Malay commercial and managerial class.

The losers in this strategy have been the Chinese business community. Certainly, prominent Chinese businessmen who have cultivated close personal relations with Prime Minister Mahathir and other UMNO leaders have earned rewards in terms of control over, and sometimes partial ownership of, privatised state enterprises. But the thousands of small and medium scale Chinese businesses that comprise the largest segment of domestically owned business have been for the most part excluded by ethnic preferences from enjoying the benefits of liberalisation. Focusing on retailing, services, real estate and construction, they have shared to only a limited extent in the benefits of export-oriented industrialisation in partnership with foreign manufacturers—who prefer in any case to choose Malay partners in order to smooth investment approvals and ensure a sympathetic regulatory ear in high places. Yet this situation is unlikely to have political repercussions for the governing coalition. This is true for reasons that go beyond the fact that the dominant Chinese party, the MCA (which enjoys the nominal support of most Chinese business), is linked to UMNO as a subordinate party in the ruling Barisan coalition. It is true also because the largest opposition Chinese party, the Democratic Action Party, is an unpalatable alternative to Chinese business because of its leftist past, and because the largest Chinese 'tycoons' are deeply dependent on UMNO leaders' good offices in obtaining regulatory approvals and waivers from government departments.

There is another way in which changing business–government relations have been associated in recent years with the changing politics of representation in Malaysia. The rapid proliferation of companies owned by, controlled by or in some way related to the ruling party has freed UMNO from its longstanding dependence on the MCA for electoral campaign financing, and has thereby weakened ties that bind the coalition parties together (Wong 1990: 110). Moreover, as UMNO-linked companies have grown stronger—strong enough even to contemplate a serious bid for control of Multi-Purpose Holdings, the corporate arm of the MCA itself—strain between the two ethnic elites has risen to levels unprecedented since the informal 'settlement' of the ethnic question in 1957 (Wong 1990: 117, n. 7). The Malay elite's coming to full financial maturity, after decades of subservient status, has in effect led to a de facto recasting of the relationship between the communal elites. The non-Malay political elites have been marginalised as the balance of both political and economic power now rests with the Malay elite, and this in turn has encouraged the representation of non-Malay business interests directly to Malay government leaders, thereby bypassing the increasingly irrelevant Chinese and Indian political parties. Consequently, as non-Malay business has withheld real support from the MCA and the MIC (the Indian party), these parties have threatened to disintegrate as a result of factional infighting, forcing unwilling UMNO leaders sometimes to step in to shore them up, if only to ensure that the illusion of a multi-ethnic coalition government is perpetuated (Nathan 1990: 215).

There is now a premium on local business (both Malay and non-Malay) establishing personal, client-like ties with leading Malay patrons associated with the long-lived Mahathir administration. In the past, such relations were subsidiary to the representation of business interests through the MCA and the MIC. Today, however, direct personal access is perceived to be a *sine qua non* for obtaining lucrative partnerships in privatised government operations and infrastructure projects. The existence of these personal ties indicates that policy makers in Malaysia are by no means completely insulated from business. Business, however, is clearly the client in this hierarchical structure: the Malay political elite controlling the state apparatus holds most of the cards.

Such relations are no doubt costly to national development: patrons command rewards for their benevolence which act as a drain of investment funds into non-productive uses. The business opportunities that flow the way of leading politicians and UMNO-linked companies are part of an (as yet) sparsely documented system of reciprocity, whereby business grants 'a piece of the action' in return for state support and protection from unexpected regulatory outcomes.

CONCLUSION

Malaysia's economy has never been a free market wherein prosperity flows as the elemental forces of capitalist entrepreneurship are given free rein. Even under the relatively laissez-faire regime of the 1960s, the government's commitment to market mechanisms and private entrepreneurship was tempered by a prior concern with improving the economic status of the Malay community, especially in rural areas. Thus Malay political elites have never embraced the view that the unfettered operation of the free market would lead to an outcome politically acceptable to the majority.

On the other hand, despite having experienced NIC-like rates of growth, Malaysia has never closely resembled the NIC developmental state model often associated with South Korea and Taiwan, in which 'sunrise' industries are championed (and declining industries retired) by an elite planning meritocracy which is insulated from particularistic political pressures by a somewhat authoritarian regime (see Johnson 1987: 136–64). The characteristic patterns of business–government interaction in Malaysia have not permitted government economic decision makers to insulate themselves from societal (especially business) pressures to the same extent that the South Korean decision makers were able to under the dictatorship of Park Chung-Hee. During the phases of market-led, state-regulated and state-led growth that characterised Malaysia's industrial development policy during the 1960s, 1970s and early- to mid-1980s, respectively, the state has been both dependent on foreign investment and at the same time tied in a symbiotic relationship with domestic business that is largely, but not exclusively, ethnically defined.

During the past five years of rapid industrial growth accompanied by a reduction in the state's direct role, Malaysia's economic decision makers have come to rely more heavily than before upon foreign investment for the achievement of their goals. Conversely, in domestic business state dominance has increased, as a result of the ruling party's success at securing its own financial future by means of corporate holdings and the increasing importance of patron–client ties. Moreover, the emergence of a Malay bourgeoisie dependent on the state for its present prosperity has enabled the state to foster domestic business without being seen to buttress the historic dominance of the Chinese in the domestic economy.

This situation would seem to invite a directive, developmental role for the state, the more so because the state in Malaysia has shown no lack of enthusiasm for provision of collective goods. Recognising that private sector provision of such goods is limited by their investment 'lumpiness', extended gestation and uncertain market prospects, not to mention the externalities involved, the Malaysian state has been more aggressive than those of Thailand, Indonesia or the Philippines in developing networks of highways, gas pipelines and electricity grids. One example is the action being taken to bring Malaysian natural gas from the east coast to industrial users and eventually household consumers on the west coast, thereby to speed the pace of economic change and to save crude petroleum for export. But the state has tended since 1986 to disaggregate and privatise large infrastructure projects (as in the case of the gas pipelines and reticulation grids) and to parcel them out to well-connected individuals or *bumiputra* companies with UMNO links—usually in association with a foreign partner with technical expertise—rather than to undertake the projects itself. This eases the financial strain on the public purse and bolsters private sector construction while, in the case of politically connected companies, ensuring a steady flow of public moneys into UMNO corporate coffers.

That Malaysia's state does not go further than this and orchestrate industrial change is in part because of the still fresh memories of the debacle of the state-led heavy industries policy in the 1980s, and in part because the state has not had to direct scarce resources—foreign investment has flooded in at rates that MIDA is hard put to record, much less direct. With aggregate figures showing the overall economy running in high gear, the challenge of how to link the dynamism of the foreign sector to a fragile, nascent locally owned manufacturing sector has barely been considered.

There is an inherent fragility in the current Malaysian industrial 'take-off'. In the absence of evidence of significant technology transfer and linkage effects in the leading sectors of electronics and electrical appliances, there is little reason to be confident that present industrial growth rates could be sustained if the attractiveness of other sites (Thailand, Indonesia or China, for example) were to overshadow that of Malaysia in the eyes of the foreign investor. With an open financial system there is nothing to stop capital from leaving; and Malaysia is too small a market for the government to be able to use the 'carrot' of access to the millions of Malaysian consumers as a means to perpetuate investment inflows. In this sense, the foreign capital flow into Malaysia represents a problematic entree to the fruits of the new international division of labour. The size of its relative impact on economic growth and structural change demonstrates the continuing fragility of the Malaysian 'miracle' and its vulnerability to changes in the flow of foreign investment.

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7 From Clientelism to Partnership: Business–Government Relations in Thailand

Anek Laothamatas[1]

Although the origins of capitalist-style development in Thailand can be traced back to the mid-19th century, it is the impressive economic achievements of the last three decades that attract most attention. During the 1960s and 1970s the average annual rate of economic growth was 7–8 per cent. Following a difficult period of economic adjustment in the early 1980s, between 1988 and 1990 Thailand notched up double-digit growth rates and was celebrated as one of the world's fastest growing economies.

Thailand is classified by the World Bank as a 'middle income' country. Compared with most 'Third World' economies it has a very small public sector. In 1989, for example, central government expenditure was 15.1 per cent of GNP, a figure smaller than that of Malaysia (30.1 per cent), the Philippines (15.7 per cent), Indonesia (20.6 per cent) and Singapore (23.3 per cent) (World Bank 1991: 224–5). The private sector in Thailand is dominated by the local Sino-Thai business class. While foreign direct investment holds an important place in the economy, its share of total investment—even in the period 1988–90 when foreign capital poured into the kingdom at an unprecedented rate—did not exceed 8 per cent. By contrast, in neighbouring Malaysia foreign direct investment accounted for as much as 16.6 per cent of total investment in 1989 (Robinson et al. 1991, Table 15).

Over the past decade the relationship between the state and the business community in Thailand has changed from one of clientelism—with the state as the patron and business as the client—to one largely of equal partnership. In comparative perspective, the Thai government–business model has approached that of the Northeast Asian NICs in terms of cordial collaboration between the two sectors. However, the Thai model is characterised by a larger and more active role for business in policy-making processes. Another marked departure from the Northeast Asian model is that the Thai government–business relationship has retained a substantial degree of government corruption. Yet, unlike most Third World states, Thailand has not seriously suffered from economic mismanagement and stagnation as a result of corruption.

THE BUREAUCRATIC POLITY AND TRADITIONAL GOVERNMENT–BUSINESS RELATIONS

While our main interest is in the dynamics of government–business relations over the past three decades, it is useful for the reader to have a historical overview of the country up to the late 1950s. Thailand is among the few Third World countries never to have been formally subjugated by any Western colonial power. Modern politics in Thailand began in 1932, with the overthrow of royal rule by a small group of military and civilian officials aiming to found a democratic constitutional monarchy. But the country rapidly fell under the rule of military juntas or elected governments which relied much more on the approval of the generals than on political parties and popular consent.

The four decades following the end of the absolute monarchy saw the military–bureaucratic elite dominate the political scene. Together, three army strongmen—Pibun, Sarit and Thanom—served as premiers for a total of 32 years during the 1932–73 period. Whether elections were allowed or not, military–bureaucratic officials overwhelmingly dominated the ranks of the cabinet ministers. Only one of the 228 men who served as cabinet ministers under premiers Pahon and Pibun between 1932 and 1944 (when elections were regularly held) was not a bureaucrat; and of the 97 people who served as cabinet members under Sarit and Thanom between 1959 and 1973 (when parties and elections were largely banned) only seven did not come from a bureaucratic background (Rungsan 1989, Table 1, Appendix).

The pre-eminent position of the military–bureaucratic elite led the noted political scientist Fred Riggs to describe Thailand as a 'bureaucratic polity' (Riggs 1966). Political and bureaucratic power in the bureaucratic polity, Riggs explained, was fused, as top military–bureaucratic leaders became political power wielders themselves. These military–bureaucratic leaders usually rose to power through coups—events which have taken place more frequently in Thailand than in any other nation. On average, there was one coup attempt every three years between 1932 and 1973. In addition to the power of the military–bureaucratic elite, the bureaucratic polity also rested on the weakness of non-bureaucratic forces. Political parties, whenever permitted to operate, were the creatures of leading politico-bureaucrats and such interest groups as existed were few in number and weak in action. The private sector was no exception; although business leaders commanded large fortunes they had remarkably little political influence. Riggs was so struck by this phenomenon that he coined the term 'pariah entrepreneurs' to describe Thai business people.

The disjunction between wealth and power during the bureaucratic polity era was due largely to the fact that most local entrepreneurs were ethnic Chinese. As late as the early 1950s ethnic Chinese accounted for 70 per cent of 'large' and 'smaller' business owners or managers in Bangkok.[2] For many decades after the kingdom opened itself to international capitalism in the mid-19th century, Chinese merchants served as the junior partners or middlemen of Western capitalists and, to a lesser extent, the royal treasury. Taking advantage of their closer cultural and commercial ties with the local population, the immigrant Chinese population managed to replace Europeans in various business sectors. By the late 1940s the role of the Chinese in the economy was already conspicuous, accounting for as much as 70 per cent of non-Thai capital invested in firms with assets of US$ 50 000 or more (Suparb 1969: 329).

Traditionally, the Chinese were well assimilated into Thai society, and the attitude of state officials towards them had been quite positive.[3] However, during the 1940s and 1950s government policy became increasingly anti-Chinese. This, coupled with their humble social and educational background, led the Chinese to avoid electoral and pressure-group politics. Instead of taking conspicuous collective action, they sought to influence government officials in a covert, defensive and non-policy-oriented fashion. In order to secure political protection, Chinese merchants typically gave bribes to law enforcement officers or nurtured connections with government leaders by inviting them to join their boards of directors. A mid-1950s survey found that 60 per cent of the most influential Chinese had prominent Thais serving alongside them on company boards (Skinner 1958: 305).

The absence of direct political leverage on the part of the business community did not, however, mean that it exerted no influence at all on the state. In a market economy, capitalists are inevitably in a privileged position to obtain policy concessions from the state because 'jobs, prices, production, growth, the standard of living, and the economic security of everyone' depend very much on the performance of business (Lindblom 1977: 172–3; Block 1981: 36–7). A major function of the state, therefore, is to see to it that business people perform their 'tasks'. However, in a capitalist system entrepreneurs cannot be simply commanded by the state to perform; they must be induced with a range of incentives, such as tax concessions, subsidies, loans and a sound socio-political framework. Thus, regardless of the low political profile of business people, the state has been obliged to grant them many policy benefits due to their strategic position in the economy.

Given this, one may argue, as Kevin Hewison does, that the Riggsian notion of bureaucratic polity overlooked the economic or structural constraints that the Sino-Thai entrepreneurs—politically weak though they were—could impose on the state (Hewison 1983). Be that as it may, it is unlikely that the structural economic influence of business was substantial during the pre-1973 period, since the economy at that time was still in an early stage of capitalism. As late as 1970, agriculture, which was dominated by small farmers, accounted for about 80 per cent of the population. Equally noteworthy is that in the late 1950s, when the bureaucratic polity reached its zenith, only 2 per cent of existing factories were classified as large, that is, with more than 50 employees (IBRD 1959: 89). Furthermore, during this period the economic role of the state, by comparison with the private sector, was very prominent. In terms of investment, between 1952 and 1957 gross fixed investment by the state ranged from 47 to 62 per cent of total investment (IBRD 1959: 91).

More broadly, the structural power of capitalists has been constrained by the prevailing ideological climate. This includes the extent to which government officials and the public believe that private property is sacrosanct, that private entrepreneurs are also delivering goods for the public when they make a profit, and that it is inappropriate for the state to involve itself directly in commercial or industrial activities. During the 1930s and 1940s government economic policy became increasingly nationalistic, leading to the creation of extensive state-owned enterprises and the harassment of Chinese merchants. In the 1950s economic nationalism declined but opposition to (Chinese) communism emerged as another convenient justification for officials to continue to repress Chinese merchants. The vulnerability of ethnic Chinese merchants to popular and official harassment was portrayed by one local newspaper in the 1950s in the following terms:

> It is easiest in the world to bleed Chinese in our country. Merely preferring a charge of being communist or having communist tendencies is more than sufficient for members of the police to obtain huge sums of money from them as they please.[4]

In short, although the bureaucratic polity was economically organised along the lines of capitalism, the state displayed a relatively high degree of autonomy vis-a-vis the capitalists. While, in the Marxist perspective, the bureaucratic polity was classifiable as a capitalist state on the grounds that it provided the framework necessary for the operation of a capitalist economy, it was more a case of a state run 'for' capitalists rather than a state run 'by' capitalists.

THE DECLINE OF THE BUREAUCRATIC POLITY

Relations between business and government began to change in the late 1950s with the advent of the Sarit Thanarat regime. Unlike previous military strongmen, Marshal Sarit abrogated the Constitution and ruled without an elected legislature. In so doing, he dispensed with the democratic trappings which had been legitimating institutions under preceding regimes. Instead, like Park Chung-Hee in South Korea, Sarit relied upon rapid economic development to legitimate his autocratic rule.[5] Although Thailand under Sarit continued as a bureaucratic polity in that political power continued to rest in the hands of the military–bureaucratic oligarchy, the strongly pro-growth orientation of the new regime meant that it became even more a state run 'for' capitalists, and simultaneously sowed the seeds of change which would lead to the emergence of a state run 'by' capitalists.

Sarit's legacies were twofold. On the one hand, he vigorously streamlined those sections of the state responsible for economic management and placed trained economists, or technocrats, in key policy positions. For instance, the central bank (the Bank of Thailand) was headed by a highly qualified economist, Dr Puay Ungpakorn, whose vision, integrity and capability have been legendary. Equally important, under Sarit the focus of economic policy was broadened beyond the traditional emphasis on financial and monetary stability, and for the first time economic growth was made a central priority. To this end the National Economic Development Board and the Board of Investment, staffed and led by capable technocrats, were created and put under direct control of the premier (Silcock 1967: 258–88).

The other major legacy of Sarit was the abandonment of the economic nationalism of his predecessors. The expansion of the public sector was checked, and a number of existing state enterprises were sold or leased to the private sector. Anti-Chinese sentiment was allowed to die down as the government abandoned earlier attempts to replace Chinese or Sino-Thai businesses with those of indigenous people. Instead, the Chinese were gradually absorbed into the mainstream society and allowed to play a full economic role. As part of this turning away from economic nationalism, barriers to direct foreign investment were lowered, leading to a big increase in Western and Japanese ventures with local business people.

It must be quickly added that, notwithstanding the pro-business and pro-technocrat character of the Sarit regime and its immediate successor, corruption and clientelistic networking remained pervasive. While nationalistic harassment ceased to pose a threat, maintaining ties with powerful politico-bureaucrats was still highly valued by business people for such links helped overcome bureaucratic inconvenience or delay and delivered certain privileges and even contracts. On Sarit's death the press revealed that he had been involved in numerous corrupt arrangements; a scandal which led to the posthumous confiscation of his assets by the government. One well-informed source claims that, in the late 1960s during the time of Premier Thanom (Sarit's close associate), there were more than 80 senior military officers who were each connected in a patron–client fashion to at least one established firm (Morrell 1974: 1026–28).

Be that as it may, the overall impact of Sarit's legacies has been a level of sustained high economic growth not previously witnessed in Thailand. Between 1965 and 1990, GNP per capita grew at 4.4 per cent annually; of the 125 countries covered by the World Bank in 1992 only 8 outranked Thailand in this respect. Over the 1965–90 period the share of agriculture in GDP declined from 32 per cent to 12 per cent, while that of manufacturing rose from 14 per cent to 26 per cent (World Bank 1992: 222–3). Also outstanding was the share of manufactured goods in total merchandise exports which jumped from 10 per cent in 1971 to about 66 per cent in 1991 (Narongchai et al. 1991: 6).

Almost inevitably, sustained economic development on this scale gave rise to new non-bureaucratic forces that could not long be excluded politically. The first such group to make their presence felt in a conspicuous way were college students. In 1973 students led a popular uprising that toppled the military regime which had succeeded that of Sarit. For most of the time since that dramatic upheaval, the military–bureaucratic oligarchy has recognised the need for power sharing with non-bureaucratic forces. The most successful formula for power sharing to emerge was that developed under Premier Prem, a retired army chief who ruled from 1980 to 1988. Throughout this period governments came to power on the basis of competitive elections. However, the ruling parties opted to invite respected retired generals to serve as premier and fill key cabinet posts, with the remaining ministries being distributed among elected politicians. This arrangement recognised (a) the fact that army support continued to be an indispensable condition for stable rule, and (b) the difficulties in achieving agreement among coalition partners as to who should become premier in Thailand's fluid multi-party system.

After Prem stepped down, Thailand had for the first time in more than a decade a fully elected government with Chatichai Choonhavan, leader of the largest party, becoming premier. Unfortunately this democratic regime did not last long, as it was overthrown in a bloodless coup in February 1991. Yet within fifteen months the new military regime was shaken by a massive demonstration which was at times joined by 300 000 to 500 000 men and women. After the occurrence of a series of bloody crackdowns on the demonstrators the King intervened, causing the leader of the much-hated regime, General Suchinda, to resign as Prime Minister. An interim civilian government was installed, followed by a new general election in September 1992 which resulted in the formation of a coalition government under the leadership of a civilian, Chuan Leekpai.

BUSINESS AND ELECTORAL POLITICS

Although they were not central to the prying open of the bureaucratic polity, business people have reaped the greatest benefit from the political liberalisation that has taken place since 1973. A legion of well-educated and 'Thai-ified' business people have entered political parties, the House of Representatives and government cabinets. As many as 27 of the 51 members of the executive committees of three leading parties (Chat Thai, Kij Sangkom and Prachatipat) in 1974 came from business backgrounds. Following the election in 1975 business became the largest group in the House, making up 35 per cent of the total membership. The proportion of cabinet members with a business background has also increased markedly since that time, reaching almost 50 per cent during the 1980s (Anek 1992: Tables 2.2 and 2.3).

Democratisation aside, the political emergence of business has been propelled by its newfound social and economic strength. During the 1970s private consumption was nearly six times greater than public consumption, while private investment was almost three times larger than public investment (World Bank 1984). By 1979 only nineteen of the 100 largest enterprises (in terms of assets) were government-owned, and these nineteen held only 36 per cent of the total assets (Suehiro 1985, Table VII-2, pp. 7 and 10). By way of contrast, in the more typically statist economy of India 47 of its top 100 enterprises (in terms of capital) in the early 1980s were owned by the state, and these enterprises accounted for 76 per cent of the total capital assets of the group.[6]

Equally crucial, local businesses in Thailand have not been eclipsed by multinational corporations and thus the problem of businesses being denationalised, as frequently reported in much of Latin America, hardly exists. Among the top 100 enterprises in the country in the late 1970s, 81 were private firms and 52 of these were local (Suehiro 1985: Table VII-2). These local firms had combined assets five times greater than those of the 29 leading foreign firms. Thai capital accounted for as much as 92 per cent of the assets of the top 100 firms in the banking and finance industry of the country in 1980 (Kraisak 1984: Table 2). Thai ownership in key industrial sectors in the early 1980s, though less towering, was prominent. For example, local businesses owned as much as 45 per cent of both the automobile and textile industries (Hewison 1985: Table 10.3). Not only have Thai firms not been gobbled up by foreign capital at home, but recently an increasing number of local firms have aggressively expanded overseas. By 1991 at least eighteen large Thai firms had made direct investments in Indonesia, Vietnam, China and the United States (Thai Farmers Bank's *Saroop Kao Turakij*, 1–15 July 1991: 10–11). Of these, the CP conglomerate is one of the largest foreign investors in China, the Saha Union Group operates a modern textile plant in the United States, and the Unicord Group has acquired Bumble Bee, a leading firm in the American canned tuna industry. As many as 85 other large Thai firms are operating in neighbouring resource-rich Myanmar (*Sayamrat Weekly*, 27 October—2 November 1991: 8–13).

Along with their economic strength, the majority of ethnic Chinese business people have acquired Thai citizenship and family names and received a Thai education. By 1973 it was found that 63 per cent of Chinese-dominated trade association members and 87 per cent of their presidents held Thai citizenship. A survey held in the late 1970s found that about three-quarters of business leaders were graduates of colleges and universities. As Chinese schools are allowed to operate only at the primary level, this finding suggests that ethnic Chinese (who constitute the core of the business elite) have been much exposed to Thai culture through the educational system. Many people of Chinese descent have also come to attain high-ranking positions within the bureaucracy, traditionally the domain of the indigenous elite. Conversely, family members of the indigenous bureaucratic elite have entered the ranks of the Chinese-dominated business elite in significant numbers; in the late 1970s one-fifth of business leaders were children of government officials (Suthy 1980: 58).

By comparison with the bureaucratic polity period, the number of business people entering parliament and even the Cabinet has grown very rapidly. Important though this development is, the impact of these entrepreneurs-turned-politicians on economic policy formation should not be overstated. In the first place, while the policy input of politicians has sharply increased, technocrats continue to dominate the policy process. Secondly, parties and politicians still lack interest and expertise in many areas of policy. It is still the case that political parties in Thailand are primarily vehicles for personal gain and patronage, and as a result their focus has been on distributive issues rather than on ideology or broad development policy. Finally, as mentioned earlier, it has often been the case that a non-elected premier and more than three or four parties have been needed to form a workable Cabinet. As a result, when the coalition partners have been divided (a not uncommon occurrence), the preferences of the non-elected premier have usually been decisive. Not being elected, premiers in this situation have been less constrained by party or parliamentary considerations and have tended to draw heavily on the advice of bureaucrats.

THE RISE OF BUSINESS ASSOCIATIONS

Much more important for the advancement of collective business interests than the parties or the parliament have been various industry associations which came to prominence in the 1980s. While detailed evaluation of the political effectiveness of business associations is a difficult task, there have been ample cases indicating the success of Bangkok-based associations in initiating, deflecting or even blocking important government policies (Anek 1992: 94–100). Since the late 1970s there has been a surge in the number and range of activities of business associations. Although the first trade associations in Thailand were founded as early as the 19th century, in 1975 there were only 75 in Bangkok. The number then rose rapidly to 124 by 1979, and to 177 by 1987. The proliferation of provincial chambers of commerce has also been striking. Whereas in 1979 there was only one chamber in each of four provinces, by 1987 chambers of commerce had spread to all 72 provinces, not to mention the Bangkok metropolis. More broadly, the complaints, grievances and demands of organised business came to feature prominently in the press.

The most important development in this respect since the late 1970s has perhaps been the persistent lobbying of the three leading associations (the Thai Bankers Association, the Thai Chamber of Commerce and the Association of Thai Industries) for the creation of a national forum for policy dialogue between the government and organised business. Their efforts paid off in the early 1980s when Premier Prem decided to install a system of Joint Public and Private

Sector Consultative Committees (JPPCCs). The national Committee consisted of the premier, ministers in charge of economic portfolios and leaders of the three flagship business associations, with the official National Economic and Social Development Board (NESDB) serving as its secretariat. Paralleling this national-level arrangement were provincial Committees, each comprising the governor, officials in charge of the province's economic and business affairs and provincial affiliates of the national flagship associations.

Throughout the Prem premiership, business also succeeded in placing on the national political agenda a range of burning issues such as the need to streamline the bureaucratic machinery overseeing export industries, the need to reduce business costs arising from inefficient or corrupt officials, and the need to revise an outdated and regulatory environment (Anek 1992: 121–48). In seeking to induce policy cooperation from the government, business groups generally employed non-confrontational tactics. Occasionally though, they have resorted to more aggressive means to advance their policy preferences. For example, in 1982 the Rice Mills Association refused to buy paddy from farmers as a gesture of protest against the rice policy of the government. More recently, enterprises involved in seed oil extraction resolved to take the Revenue Department to court in a bid to challenge its taxation policy on their raw materials. Such action would have been unthinkable in the bureaucratic polity era. Similarly, in recent years organised business has also 'trespassed' in policy areas that have traditionally been the exclusive domain of the military and bureaucratic elite. Examples include business involvement in moves to liberalise border trade with Laos and Cambodia, and criticism of the government's enforcement of law and order in southern provinces with insurgency problems. Although issues of this sort are inherently more difficult for business associations to influence, the very fact that they become involved at all is a clear indication of the newfound political confidence and assertiveness of the Thai business community.

Provincial chambers of commerce, by contrast, have not been as potent as their Bangkok counterparts due to their relatively late development and weaker socio-economic position. To make up for their individual weaknesses they have combined forces in region-wide groupings and as a nationwide Inter-Provincial Chamber of Thailand. Common efforts made by provincial chambers have produced some notable achievements, including successfully opposing a proposal for compulsory membership in the newly created Federation of Thai Industries, and successfully demanding greater participation in the executive board of the Thai Chamber of Commerce. Although there are other issues on which the provincial associations have been less successful, it is generally the case that over the course of the 1980s they succeeded in placing regional business firmly on the national political agenda.

The proliferation of business associations during the 1980s and their growing impact upon the policy process (especially in the case of the large Bangkok-based peak associations) should not lead one to the conclusion that the state played a subordinate role in the restructuring of government–business relations. On the contrary, the Prem administration was highly supportive of the JPPCC system and the business association movement, viewing them as a means of giving the private sector a larger role in the making of public policy. The economic crisis of the early 1980s, during which growth slumped and the deficit on the current account ballooned, was widely regarded as the worst since 1932 and drove the government to undertake major structural reforms. Advised by the IMF and the World Bank, the Prem administration moved the economy on to a more export-oriented footing and allowed a much stronger role for the private sector in development. It was in this context that the JPPCC system was created as a means to identify and tackle problems obstructing business expansion. As such, Prem was the first prime minister to move to include business representatives in the policy formation process.

These more inclusionary arrangements have certainly enhanced business access and influence, especially in the commercial, industrial and (to a lesser extent) agricultural sectors. Some areas of policy—such as financial and monetary affairs—have, however, been much less susceptible to private sector pressures. This can be well illustrated by two specific cases: the government's moves to rationalise the financial sector between 1983 and 1986; and its decision to devalue the baht by 15 per cent in late 1984.

The first case stemmed from widespread mismanagement and malpractice in the financial sector which saw banks and finance companies extending heavily discounted loans to their own directors, grossly overinvesting in questionable real estate projects, and rigging stock market operations. The government's response was to introduce several new laws prohibiting unprofessional practices in the industry, giving the Bank of Thailand greater powers to control poorly run financial institutions, and restructuring the fledgling stock market. Most of these new laws were introduced as emergency executive decrees after being drafted by the Bank of Thailand and the Ministry of Finance, with little if any participation by the business associations from the financial sector. Added to this, two member banks of the powerful Thai Bankers Association had their directorships purged and were put under the close control of the Bank of Thailand between

1984 and 1986. Similarly, between December 1983 and September 1985 the government took action to revoke the licences of twelve finance companies, a move which ultimately led to the demise of the association created to represent non-bank financial institutions.

The case of the 15 per cent devaluation centred on the swift and unexpected decision by the government in November 1984 to shore up the international financial position of the country. For Thailand, with its long history of financial conservatism, a 15 per cent currency devaluation was a dramatic event. Despite the strong business and military presence within the government, the decision was made secretly by the prime minister and a small group of his key technocrats. Even political heavyweights such as the army commander-in-chief and a deputy finance minister (who happened to have a business background) were not informed or consulted beforehand.

After the decision was implemented, the government met harsh criticism from dissenting business groups and the military leadership. The autonomy of the state was seriously tested as several influential banks, the Association of the Thai Bankers and even some cabinet members attacked the devaluation and pressured the government to reverse its decision. The army leadership went as far as publicly calling for the sacking of the Finance Minister and, ominously, indicating that a coup was imminent if the government failed to back down. So strong were the pressures that it was widely reported that sections of the business community had begun to hoard US dollars in expectation of a policy reversal by the government. However, with the support of the monarchy, the urban educated middle class and the mass media, the government held fast to its original position and rode out the storm (Anek 1992: 139–44).

THAILAND IN COMPARATIVE PERSPECTIVE

A good way to understand the relationship between government and organised business in Thailand more fully is to compare it with the more widely analysed systems of the Northeast Asian NICs and Singapore.[7] It is well known that the government–business relationship in these countries has been a very close one. Meetings between public officials and business representatives have been extensive and regularised. Business associations, especially those dealing with export promotion, are numerous and active and their problems are well attended to by the government. In South Korea, for instance, all registered exporters are members of the Korean Traders Association which, together with 30 specific export associations, has assisted the government to set goals and targets for various export items and to promote the marketing of Korean products abroad (Rhee et al. 1984: 53). Similarly, in Singapore organised business is represented on the Trade Development Board, which is responsible for the formation and implementation of export policies (Rhee 1985: 236–8).

While business associations do play a role in the policy processes of the Northeast Asian NICs, because they have been closely controlled by the state their part has been confined to offering advice or assisting in the execution of government-initiated programs. Until recently there were few reports from these countries of organised business initiating, deflecting or blocking government policy measures. Business associations in the Northeast Asian NICs appear to have served much more as channels through which government policies were relayed to the business community than as vigorous representatives of business demands. In South Korea, for example, it is reported that:

> All of the business associations . . . are extremely susceptible to government manipulation, and spend most of their energies reacting to various drafts prepared by the government rather than initiating policies. Association leaders are occasionally consulted in the decision phase of the policy process, but their effective ability to initiate rational policy is viewed somewhat contemptuously by government policy-makers. (Park 1987: 906–7)

In short, however intimate and pro-business the government–business relationship in the Northeast Asian NICs has been, the state has been a state run 'for' capitalists rather than a state run 'by' capitalists.

Thailand shows some signs of approaching the Northeast Asian pattern in that formal dealings between policy makers and business leaders are becoming closer, more cooperative and regular. Beyond this, however, the contrasts are quite marked. Perhaps the most notable difference is that organised business in Thailand has played a substantial direct role in initiating and blocking policy measures.[8] As noted earlier, only in the areas of financial and monetary policy can one say that the Thai state is highly autonomous in relation to business. If the power equation between government and business has been tilted clearly in favour of the former in the Northeast Asian NICs, in Thailand it has been a much more equal partnership. The stronger policy role assumed by Thai business is conditioned to a large extent by, among other things, the existence of a more liberal political climate and a larger role of business in electoral politics. Closely related to this is another crucial difference between Thailand and the Northeast Asian NICs: corruption and patron–client links between officials and business people are pervasive in Thailand. This is a subject to which we now turn.

CORRUPTION

It is commonly argued that one of the factors distinguishing the Northeast Asian NICs from most other developing countries is the relatively high degree of integrity displayed by their political leaderships and bureaucracies. Rent-seeking and corrupt activities of state officials appear to have been kept at comparatively modest levels in these countries. In Taiwan according to Gold (1986: 125): 'Cronyism and corruption existed, but so did genuine opportunity. This sets Taiwan off from such Asian neighbors as the Philippines, Indonesia, and to a large extent, Thailand'. Even in South Korea, where government officials enjoyed considerable discretionary powers to reward or punish particular firms, Jones and Sakong (1980: xxxi) found that they generally acted in good faith.

If the Northeast Asian NICs are exceptions to the norm among developing countries in terms of the integrity of their government officials, Thailand is certainly not. As discussed earlier, patron–client links have been a characteristic feature of business–government relations in Thailand for decades. This, together with the limited levels of organisational coherence and discipline in many parts of the Thai bureaucracy, has contributed to widespread corruption. However, having said this, it is important to note that since the October 1973 student uprising and the resulting collapse of the country's longest lasting military regime, there has been a gradual long-term decline in the scale of clientelism and corruption in Thailand. There are several reasons for this. First, in line with the surge of public resentment in the mid-1970s to nepotism, corruption and the abuse of official power, the creating of patron–client ties by inviting senior officials to join business executive boards was subject to harsh criticism. At the same time, fragmentation and instability within the upper echelons of the military made clientelistic ties with the military and bureaucratic elite less productive and less reliable for private firms. As a result, the military–bureaucratic presence on the boards of business corporations went into decline. Illustrative of this trend was the move during the mid-1970s by the Bangkok Bank (the largest private bank in Southeast Asia) to appoint a professional banker to its presidency for the first time ever. The growth of policy-oriented forums between the government and business, and the greater receptivity to organised business representation during Prem's premiership, also acted as a brake on corruption by reducing the need for business to resort to under-the-table dealings in order to circumvent unwelcome government policies.

However, with electoral politics in full gear in the later 1980s and early 1990s corrupt dealings between government and business have again picked up. In a country where vote-buying is often needed to win an election and funding for party activities and election campaigning comes mostly from covert donations (rather than legitimate government sources or publicly acknowledged donations), corruption becomes a crucial means for politicians to draw money from businesses. Along with personal aggrandisement, this political imperative to secure financial resources fuelled the upsurge of corruption under the Chatichai administration in the late 1980s. Indeed, when Chatichai's government (the first to be fully elected since the mid-1970s) was overthrown in February 1991, the military junta cited eradication of corruption as the principal justification for its action.

Notwithstanding the relative decline in the importance of clientelism since the 1970s, it remains the case that cronyism and corruption appear to be far more common in Thailand than in the Northeast Asian NICs. And yet, in spite of this—and in contrast to so many other developing countries—the existence of widespread corruption has not led to economic stagnation or decline. As noted at the outset of this chapter, Thailand has performed very strongly in the economic growth stakes. Indeed, in the late 1980s and early 1990s—the period of the allegedly very corrupt Chatichai administration—the country experienced a double-digit growth rate for three years in a row.

Although a complete explanation is yet to be formulated, some preliminary reasons may be cited to account for the paradoxical co-existence of corruption and high economic growth in Thailand. First, clientelistic networking and corruption have not thus far obstructed the search for efficient economic strategies. There is a strong tendency in the theoretical literature on the political economy of development to equate cronyism and corruption with inward-looking and market-distorting economic policies. Thai experience suggests that such an assumption may require qualification. In Thailand corruption-prone politicians have been persuaded to accept innovative and efficient policy measures, in part because they have apparently concluded that the *scope* for under-the-table dealings with business associates is much greater in a booming economy than in one which is limping along with low growth rates.[9] That Sarit replaced economic nationalism with market-oriented and private-sector-led development in the early 1960s, or that Prem downplayed import substitution and pursued export-oriented industrialisation in the 1980s, shows that corruption-prone politicians in Thailand are tolerant, if not supportive, of economic reform. The blatant cases of government officials receiving kickbacks from businesses frequently exposed by the press during the Chatichai administration suggest that under-the-table dealings between officials and business people continue to flourish in a situation where the prevailing policy disposition is towards economic liberalisation and the removal of obstacles to private sector expansion.

A second factor which may help to explain the puzzling co-existence of corruption and high economic growth is the fluid nature of Thai politics over the last two decades: no sector, group or personal faction has had a prolonged or exclusive grip on power. Following the overthrow of the longest ruling military regime in 1973, there has been intense political competition by a range of contending groups within the military and party establishments, with the monarchy and the student and intellectual communities also having a real and ongoing influence over the course of major political events. The competitive and volatile nature of Thai politics has meant that unlike the Philippines under Marcos, for instance, no particular set of vested interests has been able to use corruption, nepotism or patronage to dominate the economic decision making of the state. In short, to the extent that there is a link between clientelism and distortionary economic policies this has not been realised in a broad way in Thailand because of the existence of fierce political and economic competition.

A third possible explanation is that clientelism and corruption have had little impact upon the macroeconomic management of the country.[10] For decades the record of macroeconomic policy has been very impressive in Thailand. The rate of inflation has been one of the lowest in the developing world; government, trade and current account deficits have all been managed well above Third World standards; and the foreign exchange regime has been mainly liberal and market-conforming. Underpinning these achievements are the competence and integrity of the Ministry of Finance, the National Economic and Social Development Board (NESDB), and, particularly, the Bank of Thailand. In an important sense these technocratic agencies have been islands of rationality in an ocean of politicised economic management. Through a very long tradition of conservative financial management inherited from British financial advisers during the time of the absolute monarchy, and reinforced in modern times by the Sarit-initiated tradition of precluding parliamentarians from initiating money bills or taking a substantial part in the budgetary process, the state imparts a relatively high degree of autonomy to technocrats in handling national economic planning as well as fiscal and monetary policy. By contrast, policy formation in the agricultural, commercial and industrial sectors is much more susceptible to various pressures from military–bureaucratic leaders, professional politicians and sundry business interests. This is well illustrated by the fact that the structural adjustment reform drive under the Prem administration in the 1980s succeeded only in the financial and monetary areas, as it was here that the state enjoyed greatest autonomy from vested interests. By contrast, trade, agriculture and industry reform measures faced formidable business opposition and failed to take root (Doner and Anek 1992).

Interestingly, extensive author interviews with high officials of the NESDB and the Industry Ministry reveal that the technocrats themselves have concluded that the Thai state should limit itself to the role of macroeconomic manager, rather than delving into the making of specific industrial policies after the fashion of Japan or South Korea. They argue that, unlike the Northeast Asian NICs, Thailand lacks (a) an information system capable of collecting and analysing the necessary data at the micro or sectoral level, and (b) the necessary legal framework or economic policy instruments to make effective microeconomic intervention possible.

In sum, Thailand falls somewhere between the experiences of most developing countries and those of the highly successful Northeast Asian NICs. The Thai state has enjoyed a considerable degree of operational autonomy and has overseen sustained and impressive economic growth. However, this autonomy has been largely confined to macroeconomic policy. In most other areas of policy, patron–client links and growing group action on the part of business associations have been major variables in the policy formation process.

CONCLUSION

Government–business relations in Thailand during the days of the bureaucratic polity were primarily clientelistic in nature. Although the economy was organised largely along capitalist lines, business had a minimal role in politics and public policy making. The attitude of state officials towards the Sino-Thai business community was mixed: they provided a basic sociopolitical framework in which commerce could expand, but also adopted economic-nationalist, anti-Chinese and anti-communist measures which were often highly injurious to the operations of Sino-Thai businesses. Overall, the relations between the state and the business community under the bureaucratic polity were characterised by toleration and control—not cooperation and promotion.

Rapid socio-economic development set in motion by the Sarit regime and the opening of the political arena following the 1973 uprising enabled business people to become closely involved in politics and policy making, which in turn produced a much more sympathetic attitude among state officials towards business. This, coupled with the grave concern of Premier Prem and his technocrats over the economic crisis of the early 1980s, resulted in the official promotion of business associations and the creation of a high level system of policy dialogue between top leaders of the government and the business community. Cooperation and promotion have increasingly replaced toleration and control as the key features of official policies towards business. More broadly, government and business since the mid-1980s have been relating to each other more as partners than as patron and client.

Significant as these changes have been, some traditional elements persist. The role of business-based political parties in the initiation and systematic formulation of policies is still limited. Particularly in the areas of long-term planning and macroeconomic management, the technocrats maintain a considerable degree of independence from business interests. And despite the presence of modern institutions and processes in the relations between government and business, clientelism and corruption have not disappeared. Nevertheless, so far these substantial vestiges of older forms of government–business interaction have not seriously obstructed the newfound cordial working relationship between the two parties.

NOTES

1 This chapter draws on research material from my book, *Business Associations and the New Political Economy of Thailand* (Westview Press and ISEAS of Singapore, 1992). I am grateful to the Asia Foundation for its funding of the research which informed this chapter.
2 Calculated from the data provided by Skinner (1957: table 21).
3 Marrying local people was not uncommon among Chinese immigrants. Their children spoke fluent Thai and some of them entered the Thai bureaucracy. Indeed, it was reported that in the 19th century fourth-generation Chinese were unheard of in Thailand (Skinner 1957: 237).
4 *Sathiraphab*, 31 August 1955, as quoted in Skinner (1958: 303–4).
5 Note that Sarit's shift from preaching ideology to making pragmatic development policies was comparable with that of second-generation leaders in much of the newly independent Third World.
6 Calculated from the data provided by Rudolph and Rudolph (1987: 403–6, Appendix A).
7 Here I refer to the analyses of the development experience of the Northeast Asian NICs undertaken by scholars such as Jones and Sakong (1980); Johnson (1987); Haggard & Moon (1983); Amsden (1985); and

Haggard (1990). Emerging from these works is the so-called Northeast Asian model of statist development, with its emphasis on the role of the state in a developing capitalist economy. At the heart of the model is the notion that the state is capable and far-sighted, while societal actors are not. The key to economic success according to the model is therefore the insulation of the state from societal influence.

8 Doner (1988) also suggests that the Thai state differs from the Northeast Asian states in that it is not insulated from societal influence. However, in discussing the influence of business he notes that no private sector group has singlehandedly dominated the state.

9 For a similar view, see a stimulating article by Liddle (1991: 404) arguing that in Indonesia the patronage-ridden, patrimonial rule of President Suharto has not been a significant obstacle to the adoption of more efficient market-oriented growth policies.

10 Ammar Siamwalla, a highly respected economist of Thailand, notes that regardless of regime type (democratic, semi-democratic or authoritarian) the macroeconomic performance of the Thai state is impressive, while microeconomic activity (trade, agricultural, industrial) is fraught with nepotism, patronage and hence inefficiency and misallocation of resources (Ammar 1992: 1–26).

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8 Booty Capitalism: Business–Government Relations in the Philippines

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Most capitalist Southeast Asian political economies have experienced fundamental transformation in recent decades, as bureaucratic elites have been forced to make room for increasingly autonomous bourgeoisies. Observers of Thailand and Indonesia, for example, note 'the rise of capital', the much greater assertiveness of business associations, and 'the bureaucratic polity outgrown' (Robison 1986; MacIntyre 1990; Anek 1992; see also Doner 1991). Economies which were once perceived as stagnant sites of bureaucratic privilege and 'pariah entrepreneurship' (Riggs 1966) have since been reborn as vibrant arenas of rapid economic growth and sweeping social change. 'From our present vantage point', writes Ruth McVey, 'the features of the bureaucratic polity . . . have less the aspect of a developmental bog than of a container for fundamental transformation, a chrysalis in whose apparently confused interior the change from one sort of socio-economic case order to another was taking place' (McVey 1992: 22).

There is, however, one major capitalist political economy in Southeast Asia—that even from the vantage point of the early 1990s—remains far more a 'developmental bog' than a 'container for fundamental transformation'. The Philippines, which in the early postwar era was generally thought to have the brightest prospects for rapid economic growth in the entire region, has instead become the laggard of capitalist Southeast Asia. As we shall see, the traditional socio-economic order that one finds in the Philippines differs fundamentally from that found in Thailand and Indonesia; moreover, this order has shown itself to be particularly resistant to change. This chapter explores the underlying factors that explain the stagnation of the Philippine economy, and argues that the explanation for the country's developmental bog can be traced in large part to longstanding patterns of government–business relations and the persistence of the particular form of capitalism that these relations have engendered.

The first section of this chapter provides an overview of major characteristics of government–business relations in the postwar Philippine political economy, and contrasts the 'booty capitalism' found in the Philippines with other capitalist systems in which rent-seeking behaviour is predominant. The second section explores the historical origins of government–business relations in the Philippines, through a brief survey of the process of state formation and the creation of the oligarchy. The third section examines the contrast between the forms of patrimonialism and the types of capitalism traditionally found in Thailand and Indonesia with those that persist in the Philippines. Finally, the chapter surveys the prospects for future transformation of government–business relations in the Philippines, and concludes that current changes in the country's international environment may—over the long term—provide an impetus for major change in the nature of those relations.

GOVERNMENT–BUSINESS RELATIONS IN THE PHILIPPINES: AN OVERVIEW

A scholar of the Philippines once noted that 'business is born, and flourishes or fails, not so much in the market place as in the halls of the legislature or in the administrative offices of the government' (McHale 1959: 217). Although this observation was made over three decades ago, it could have been repeated with equal validity in each of the subsequent decades. Whether in the pre-martial law years (1946–1972), the martial law years (1972–1986), or the Aquino years (1986–1992), one finds remarkable continuity in basic patterns of interaction between the Philippine state and dominant economic interests. Even as it is often incapable of meeting even the most essential infrastructure needs of the economy, the Philippine state is nonetheless central to any comprehensive analysis of the country's political economy. Access to the state apparatus remains the major avenue to private accumulation, and the quest for rent-seeking opportunities continues to bring a stampede of favoured elites and would-be favoured elites to the gates of the presidential palace. The state apparatus is choked continually by an anarchy of particularistic demands from, and particularistic actions on behalf of, those oligarchs and cronies who are currently most favoured by its top officials: one will obtain a highly coveted loan or import licence; another will enjoy a stake in a cartelised industry protected by highly discretionary state regulations.

Because of the weak institutionalisation of the state apparatus, the personal favour and disfavour of those currently in power is a critical determinant of business success and failure. Political administration in the Philippines is often treated as a personal affair, and one can find many parallels between the modern Philippine polity and Max Weber's description of patrimonial states: 'Practically everything depends explicitly upon the personal considerations: upon the attitude toward the concrete applicant and his concrete request and upon purely personal connections, favors, promises, and privileges'.[2] It is not enough to say that the state lacks significant autonomy and capacity; in fact, to paraphrase Weber, 'the conceptual separation of the "state" . . . from all personal authority of individuals' is often remote from Philippine 'structures of authority'.[3] While all states possess patrimonial features to some degree, it is clear that there is a *particularly* large gap between the Philippine state and the archetypal bureaucratic state, where there is one objective law for all and administration is conducted without respect for persons.

Faced with the myriad particularistic demands of powerful elite interests, the Philippine state is unable to formulate or implement a coherent policy of economic development. Indeed, the Philippines presents a stark example of a state that has failed to effect the kind of economic change found among the Northeast Asian NICs. The statist model, successful though it has been in Northeast Asian settings, is not a viable option for a state with such a highly fractured and ineffective bureaucracy. Unlike the Korean and Taiwanese states, which at certain crucial historical junctures enjoyed considerable autonomy from dominant economic interests, the Philippine state is so lacking in autonomy from dominant economic interests that even the most basic regulation of capital is continually frustrated. Peter Evans (1987) notes that the bureaucratic capacity of the 'developmentalist states' of Northeast Asia can only be understood as part of a long historical experience; similarly, Haggard and Cheng (1987) note that 'development models are not simple packages of policies; they are configurations of political, institutional, and historical events'. In the Philippines, this long historical project has yet to produce anything resembling a developmentalist state.[4]

The limitations of the Philippine state apparatus, however, go far deeper. Not only is it incapable of replicating the kind of interventionist capacity of its Northeast Asian neighbours, it is also incapable of providing the even more basic legal and administrative underpinnings necessary for 'free market' capitalism. It is commonly presumed that laissez-faire is truly laissez-faire; that is, without state involvement in the economy, the 'magic of the marketplace' will naturally take hold. If only the public sector can be shrunk to a minimum, some radical free-marketeers proclaim, capitalism will flourish. On the contrary, I shall argue, the Philippines presents an insightful study of precisely what kinds of economic problems can result from *insufficient development* of the state apparatus.

Karl Polanyi reminds us that in the development of capitalism in England there 'was nothing natural about *laissez-faire;* free markets could never have come into being merely by allowing things to take their course'. Rather, '*laissez-faire* itself was enforced by the state', and its historical development required 'an enormous increase in the administrative functions of the state' (Polanyi 1944: 139). Weber explains that 'capitalism in its modern stages of development requires the bureaucracy'; above all, advanced forms of capitalism require an administrative and legal structure able to promote 'political and procedural predictability' (Weber 1978: vol. 1, 224 and vol. 2, 1095).

> [M]odern rational capitalism has need, not only of the technical means of production, but of a calculable legal system and of administration in terms of formal rules. Without it adventurous and speculative trading capitalism and all sorts of politically determined capitalisms are possible, but not rational enterprise under individual initiative, with fixed capital and certainty of calculations. (Weber 1976: 25)

Where bureaucratic actions are often highly arbitrary, Weber is arguing, only certain types of 'politically determined capitalisms' are able to thrive. Such forms of capitalism 'often reach a very high level of development', according to Weber, but the absence of calculability in the political sphere ultimately inhibits the development of more advanced forms of capitalist accumulation (Weber 1978: vol. 1, 240). Because all capitalism is in some sense 'politically determined', I prefer to use the term 'rent capitalism' as the overarching term to describe systems in which 'money is invested in arrangements for appropriating wealth which has already been produced rather than in [arrangements for actually] producing it'.[5] 'Rent capitalism' can be distinguished from 'production-oriented capitalism' according to the relative dominance of rent-seeking and production-oriented behaviour. It is important to note, however, that no real capitalist system belongs purely in one category or the other, and that the lines between the two categories are often blurred: a system of 'rent capitalism' may register significant levels of production, and a system of 'production-oriented capitalism' may display a fair degree of rent-seeking.[6]

The Philippine bureaucracy is unable to provide the political prerequisites for the development of more advanced forms of capitalism—not only those necessary for a statist form of capitalism, but even those required by a more laissez-faire variety. It has long been penetrated by particularistic oligarchic interests, which have a firm independent economic base outside the bureaucracy, yet rely heavily upon their access to the political machinery in order to promote private accumulation. This access is largely determined on the basis of personalistic factors, as the state is incapable of maintaining even the most basic semblance of a 'level playing field'. Because the state apparatus is unable to provide the calculability necessary for advanced capitalism, one finds instead a kind of rent capitalism based, ultimately, on the plunder of the state apparatus by powerful oligarchic interests.

The dynamics of this variety of rent capitalism are perhaps best conveyed by the term 'booty capitalism', since a group with an economic base *outside* the state is plundering the state for particularistic resources. Montes is entirely correct to characterise the Philippine economy as a rent-seeking economy, and to contrast its operations with 'profit-seeking', or productivity-improving economic activities. As he writes:

> In a 'profit-seeking' economic structure, assets and income are won and lost on the basis of the ability of the business owner to develop the property . . . operations must be organized to produce a surplus and surpluses earned in the operation must be correctly reinvested. In a 'rent-seeking' society, ownership of property alone guarantees the access to wealth . . . [and] the operations of the state determine the assignment of and the continued enjoyment of economic advantages. (Montes 1988: 65)[7]

But it is important to go one step further, and focus clearly on *who* has the greatest 'enjoyment of economic advantages' within capitalist systems dominated by rent-seeking behaviour. In other words, it is important to specify the primary direction of extraction in rent capitalism.[8] Where rents are most commonly grabbed by a bureaucratic elite based *inside* the state (as in the former 'bureaucratic polity' of Thailand and Indonesia), we can speak of 'bureaucratic' capitalism; where they are generally grabbed by groups with an economic base *outside* the state (as in the Philippines), we can speak of booty capitalism.[9]

In differentiating among types of capitalist systems, I am relying on two major dimensions of variation. First, it is essential to examine the relative strengths of state apparatuses and business interests—the dimension that is commonly used to differentiate systems that fall along the laissez-faire versus statist continuum of intra-capitalist variation. A second dimension, however, is just as vital: we must focus on the variation among state apparatuses, recognising that many of these apparatuses exhibit strong patrimonial features. Along a continuum of Weber's ideal types of 'rational-legal' versus patrimonial, some state apparatuses are a particularly long distance from the archetypal bureaucratic state (see Evans 1989). While this analysis does not presume to capture all variations of capitalism within these two dimensions, it does aim to achieve a more accurate characterisation of Philippine capitalism and to highlight the need to think more critically about the great variation that exists across capitalist systems. For heuristic purposes it is perhaps useful to display the two dimensions of capitalist variation on a simple matrix, understanding that (a) both axes represent continua along which capitalist systems can be placed, and (b) despite the presence of lines separating the different types of polities and capitalist systems, there is in reality no clear demarcation among categories. On the upper portion of the matrix one finds the two major types of production-oriented capitalism, and on the lower portion of the matrix are the two major types of rent capitalism (systems in which 'rent-seeking' behaviour predominates). The horizontal axis, it is important to note, is not a measure of state autonomy: because patrimonial states by definition lack a clear separation between the private and the official spheres, they cannot be considered autonomous.

The oligarchic collectors of booty in the Philippines are well organised at the level of the family conglomerate, but very poorly organised at any broader level of aggregation. There is little separation between the enterprise and the household, and it is often difficult to discern larger 'segments of capital' divided along coherent sectoral lines. In creating and responding to opportunities for enrichment provided by favourable access to the state machinery, the major families have created highly diversified conglomerates, and few have

A Heuristic Typology of Capitalist Systems

	State apparatus relatively stronger vis-à-vis business interests	State apparatus relatively weaker vis-à-vis business interests
Relatively more 'rational–legal' state	Statist capitalism (Developmental state)	Laissez-faire capitalism (Regulatory state)
Relatively more 'patrimonial' state	'Bureaucratic' capitalism (Patrimonial administrative state)	Booty capitalism (Patrimonial oligarchic state)

any strong loyalty to specific sectors of the economy. Because particularistic access to the state apparatus plays such a central role in the creation of wealth, the most enduring division among capital is that of the 'ins' vs the 'outs'.[10]

For those families who find themselves on the right side of this ever-shifting line, the spoils are legion. As one former presidential adviser explains, 'every administration in this country has spawned its own millionaires' (interview, Adrian Cristobal, 19 June 1989). There is, in fact, a certain social mobility at the helm of Philippine society, as new families appear out of nowhere and some of the old families fall by the wayside. This steady creation of *nouveaux riches* makes it impossible to reduce the Philippine oligarchy to a certain number of old families. As new faces gain favourable access to the state apparatus, they too can achieve big-time success in Philippine business. This 'social mobility' highlights the appropriateness of the term 'oligarchy' to analysis of the Philippine political economy. We find in the Philippines not a fixed aristocracy, but rather a social group that is based on wealth and that changes over time.[11]

It is indeed paradoxical that a state so thoroughly overrun by the particularistic demands of the oligarchy should nonetheless remain a central subject of analysis. The state's important role seems to derive primarily from responsibilities it has necessarily assumed in handling the country's *external* economic relations: it disburses aid and loans received from abroad, and sets policies on foreign exchange, trade and investment. Throughout the postwar era, the country's geopolitical importance has brought huge quantities of external resources to the country, where they have been funnelled through the central government in Manila and become 'ripe pickings' for private interests.

Even as it is so thoroughly picked over, however, external forces play a key role in maintaining both the physical and economic viability of the state. Indeed, one cannot understand either the formation or the endurance of the Philippine state without considering the critical role of external forces.[12] Most importantly, the country's role as host of the US military bases has helped ensure repeated rescue from the balance of payments crises that have plagued the postwar economy. Because of the country's geopolitical importance, these bailouts have commonly proceeded even when 'conditionalities' attached by foreign aid missions and multilateral agencies fail to be met.

This combination of poorly developed state apparatus, powerful oligarchy and ready support from an external military power has left the Philippines with a 'booty capitalism' that endures to the present. As President Fidel Ramos noted in his June 1992 inaugural address, the economic system in the Philippines 'rewards people who do not produce at the expense of those who do . . . [and] enables persons with political influence to extract wealth without effort from the economy'.[13] Within this system, a kind of 'private sector initiative' overwhelms an externally stocked but nonetheless weak state in the quest for particularistic resources. This type of capitalism, however, is not self-sustaining; ultimately it depends on the international dole. As will be discussed further below, the withdrawal of US military bases can be expected to bring increasing pressure to begin to orient the system toward more internationally competitive modes of operation.

In summary, the case of the Philippines highlights important political underpinnings to the development of more advanced forms of capitalism. Not only is the Philippine state incapable of guiding the process of late, late industrialisation via the statist model, it is, even more fundamentally, incapable of providing the administrative and legal apparatus necessary for the development of free-market capitalism. The economy does not properly belong on the standard laissez-faire versus statist continuum, and can only be properly characterised through careful examination of *both* the relative strengths of the state apparatus and business interests *and* the nature of the state (i.e. the degree to which patrimonial features dominate). Until there is greater development of the state apparatus, I argue, oligarchy-dominated booty capitalism will continue to stunt the development of the Philippine economy.

STATE AND OLIGARCHY IN HISTORICAL PERSPECTIVE

As the discussion above attempts to highlight, a major puzzle in understanding the Philippine political economy is *why* the power of the oligarchy so clearly overwhelms the power of the state. Even the most cursory comparative view of Third World political economies reveals, quite clearly, that there is enormous variation among states, as well as great diversity in the character of government–business relations. Comparative historical analysis is the logical starting point for a better understanding of these critical cross-national differences.[14]

Looking across the span of modern Philippine history, one finds a striking absence of any sustained effort at state-building. In their initial efforts at colonisation in the sixteenth and seventeenth centuries the Spanish encountered very localised political units; except in the Muslim south, there existed no political units that could even begin to compare with the large pre-colonial kingdoms found elsewhere in the region. The central state that the Spanish created was so woefully understaffed that the civil authorities had to rely heavily upon ecclesiastical personnel in order to extend their reach throughout the archipelago.[15]

With the process of agricultural commercialisation that swept the world in the nineteenth century, the Spanish colonial administration in Manila was largely upstaged by other forces that were able to respond more effectively to new opportunities: British and American trading houses, Chinese traders, and an increasingly powerful landed elite in the provinces, dominated by Chinese *mestizos*. Manila was no longer the single *entrepôt*; rather, regional economies each had their own separate ties with the world market. This, writes Alfred McCoy, encouraged 'strong centrifugal forces that weakened the emerging nation'. Only in a few areas 'did the colonial government . . . control the new commercial agriculture' (McCoy 1982: 8). Unlike in Thailand and Indonesia, explains Harold Crouch, where 'bureaucratic–aristocratic' elites (descendent of pre-colonial kingdoms) were strengthened by the nineteenth-century commercialisation of agriculture, the same process in the Philippines 'gave rise to a new class of . . . landowners who were quite separate from the bureaucracy' (Crouch 1985: 10–18, quote at 10). Their economic base was firmly *outside* the state.

American colonial rule reinforced the decentralised nature of the Philippines, by concentrating far less on the creation of a central bureaucracy than on the introduction of representative institutions. As Anderson explains, 'unlike all the other modern colonial regimes in twentieth-century Southeast Asia, which operated through huge, autocratic, white-run bureaucracies, the American authorities in Manila . . . created only a minimal civil service'. The representative institutions enabled local *caciques* to consolidate their hold on the national state, and fostered the creation of 'a solid, visible 'national oligarchy''. The oligarchy took advantage of its independent base of power, and came to exercise powerful—yet particularistic—control over elements of the state apparatus through a spoils system that had become well entrenched at the national level early in the century.' Anderson continues, 'Civil servants frequently owed their employment to legislator patrons, and up to the end of the American period the civilian machinery of state remained weak and divided.' This control of the bureaucracy, it must be emphasised, was exercised from an independent societal base: while the oligarchy swamped the legislature, it showed little interest in directly assuming bureaucratic posts.[16] Despite growth in the bureaucracy, a bureaucratic elite never emerged.

Indeed, the contrast between the historical development of the Philippine bureaucracy and that of the Thai bureaucratic elite is instructive. Doeppers (1984) explains that widespread Filipinisation of the bureaucracy, in only the second decade of American rule, created opportunities for social mobility that resulted in 'the formation of an indigenous bureaucratic middle class'. But access to public education and the examination system 'ensured that the civil service did not swiftly become a self-perpetuating class', as it had in Thailand—where entrance to government posts was greatly restricted by the bureaucratic elite that consolidated its hold over the state machinery in the wake of the 1932 'revolution'. Moreover, because there were many more opportunities *outside* the bureaucracy in Manila than in Bangkok, there were certain periods in the prewar era in which many middle class Filipinos actually left the bureaucracy for jobs in business organisations. Most significantly, the old oligarchy showed little interest in moving into bureaucratic ventures: a mere handful of the highest ranking bureaucrats in 1931, writes Doeppers, were drawn from the landowning class.[17] There was little need: the oligarchy already had a firm economic base outside the bureaucracy, absolute control of representative institutions and—through the latter—thorough penetration of the administrative departments of government. If in Thailand we find an elite traditionally based primarily in the bureaucracy, in the Philippines we find a bureaucracy long subordinated to particularistic elite interests.

In short, the legacy of US colonialism was considerable 'oligarchy-building', but very little in the way of state-building. Under the American regime the oligarchy consolidated itself into a national force, took control of the central government in Manila and responded to countless new opportunities for enrichment. One source of largesse came in the form of preferential access for Philippine agricultural products in American markets. Sugar planters, enjoying the protection of US tariff laws, had little need to bring production costs down to internationally competitive levels.[18] A second source of largesse came from effective manipulation of the growing colonial state apparatus. Under the administration of the Democratic governor-general, Francis Burton Harrison (1913–21), Filipino elites began to control both houses of Congress and to enjoy considerable influence within the executive branch. Moreover, it was during this period that the bureaucracy was substantially Filipinised and a wide range of state enterprises created. Simultaneous with the expansion in the role of the state in the economy, then, was an expansion in the oligarchy's control over the state. By far the richest new source of booty for the emerging 'national oligarchy' was the Philippine National Bank. Within five years the newly empowered landed oligarchs had plundered the bank so thoroughly that not only the bank, but also the government and its currency system, were threatened by 'utter breakdown' (Stanley 1974: 233–48, at 247).

On the eve of the Pacific War, Philippine oligarchs so enjoyed the arrangements provided by the American colonial regime that they were loath to make the transition to independence (Anderson 1988: 12). When independence did come, in 1946, it was accompanied by provisions that were clearly advantageous to the landed oligarchy that controlled the state. First, a bilateral free trade agreement ensured continuing dependence on the American market. Second, a new source of riches came in the form of $620 million in US rehabilitation assistance for war damages, which helped finance 'conspicuous consumption of luxuries and non-essentials by the high-income groups'.[19]

While the consolidation of the 'national oligarchy' occurred under American colonial sponsorship, even in the post-colonial era the oligarchs have remained highly dependent upon US aid, investment and counter-insurgency support. Only three years after independence, the Philippine state nearly collapsed. Rehabilitation assistance was plundered by the oligarchs to pay for duty-free imports of consumer durables, and the government lacked the means to stem the haemorrhage of foreign exchange. The military and economic rescue operation was coordinated by Washington.[20] In part because the grantor of independence was a rising superpower—not a declining European power, as elsewhere in Southeast Asia—it was especially difficult for the Philippines to emerge as a truly sovereign nation. Throughout the postwar years, oligarchs have needed external support to sustain an unjust, inefficient and graft-ridden political and economic structure. Washington, in turn, received unrestricted access to two of its most important overseas military installations.

In summary, the combination of historical factors bequeathed to the post-colonial Philippines provided fertile ground for booty capitalism. The state apparatus remained woefully underdeveloped, easy prey for a powerful oligarchic class that had been able to consolidate its power under American colonial rule. Even though it was plundered by these oligarchs, however, the perpetuation of the state was ultimately assured by ready support from the former colonial power. Despite changes in regime, basic patterns have persisted throughout the postwar era: while the state is plundered internally, it is repeatedly rescued externally.

PATRIMONIAL STATES AND RENT CAPITALISM: A COMPARATIVE PERSPECTIVE

As noted at the outset, the stagnation of the Philippine political economy stands in marked contrast to the rapid changes that are sweeping the rest of capitalist Southeast Asia. In this section, I examine this contrast in greater detail, and explore why patrimonial features are increasingly challenged in Thailand and Indonesia, yet remain remarkably persistent in the Philippines. As the matrix above seeks to show, the Philippines provides only one example of a state with strong patrimonial features and only one example of how capitalism can be 'politically determined', or dominated by rent-seeking behaviour. Weber devoted great attention to analysing variation *within* patrimonial polities and among capitalist systems that are hampered by a weak degree of calculability in the political sphere. It is useful to extend such a discussion to modern-day patrimonial polities and capitalist systems, and to place the Philippine political economy in larger comparative context. For the purposes of analysis, I will confine the discussion to two broad types of patrimonial polities: the patrimonial administrative state (that which Riggs called the 'bureaucratic polity'), and the patrimonial oligarchic state.[21]

In the patrimonial administrative state a bureaucratic elite is the major beneficiary of patrimonial largesse and exercises power over a weak business class. The type of rent capitalism commonly engendered by the patrimonial administrative state reflects—not surprisingly—the relative strengths of the state apparatus and business interests. In his classic work on the Thai bureaucratic polity Riggs explains that government service provided 'the greatest opportunities for combining high income with security, prestige, and power', and those unable to gain admission to the bureaucracy had to settle for entrepreneurship. Because businesspeople lacked political access, Riggs calls them 'pariah entrepreneurs'. The political environment offered them little security, and in order to even engage in business they had to contribute 'financially to the private income of (influential) protectors and patrons in the government' (Riggs 1966: 250–1). As the major beneficiaries of the process of rent extraction were based in the administrative apparatus of the state, this form of rent capitalism can be characterised as 'bureaucratic' capitalism.

A quarter of a century ago, Riggs quite pessimistically asserted that pariah entrepreneurs would be incapable of altering an environment that threatened the security of long-term investments, or fostering the emergence of economic institutions more conducive to private enterprise and a free market system. He anticipated that governmental careers would remain the major avenues to prestige, power and economic opportunity, and that the authority of the bureaucratic elite would perpetuate itself (Riggs 1966: 250–1). Recent history, however, has contradicted Riggs' pessimism and has shown that within 'bureaucratic' capitalism may reside the seeds of its own destruction. As Ruth McVey (1992) explains, the bureaucratic polity may be 'a container for fundamental transformation'.

How does this change take place? Perhaps the best analysis of the dynamics of this ongoing transformation is Crouch's analysis of Indonesia—an analysis which is equally relevant to understanding the process of change in Thailand. Drawing on Weber, Crouch explains that:

> In the early stages, a patrimonial political structure need not be an obstacle to capitalist economic development. By placing themselves as clients under the protection and patronage of powerful members of the ruler's court, industrialists can acquire the security and predictability they need. But as a modern economy grows and becomes increasingly complex, industrialists require more than informal understandings with officials to assure them of the safety of their investments. (Crouch 1979: 579)

Over time, although many powerful military and bureaucratic officials will resist giving up their special privileges, one can expect a fitful process in which business enterprises require (and demand) greater regularisation and bureaucratisation.

There seem to be two major sources of regularisation and bureaucratisation: (a) piecemeal reforms, instituted from above; and (b) far more sweeping reforms, forced by the emergence of new social forces that challenge the prevailing order. In the first type of reform, the leaders of a patrimonial administrative state may support selective measures of economic reform in order to try to satisfy the political imperatives of regime preservation. Suharto and his generals, for example, were acutely aware of the fact that hyperinflation had contributed to popular discontent with the Sukarno regime, and that the long-term viability of the New Order depended on creating 'an expanding pool of available resources, not only for patrimonial distribution within the elite, but also for the pre-emption of potential opposition from outside'. In the late 1970s, Crouch explained, the major pressures for regularisation and bureaucratisation in Indonesia came from 'sections of the army concerned about the long-term legitimacy of military rule'.[22]

The second type of reform is much more extensive, and results from the emergence of new social forces able to effectively challenge the (patrimonially based) power of the bureaucratic and military elites. The basis for such conflict—fundamental shifts in the distribution of power among contending social forces—has been forming in recent decades in both Indonesia and Thailand. The dynamics of change can be summarised (and greatly simplified) as follows: (a) there is substantial economic growth, fuelled in part by foreign capital and foreign aid (and in the case of Indonesia, booming oil exports as well);[23] (b) in the process of economic growth, a more assertive business class emerges; and (c) this business class (often with the assistance of foreign capital)[24] demands the regularisation of relations between the government and business interests—a process which has advanced much further in Thailand than in Indonesia. The hegemony of the bureaucratic and military elites is challenged, and the result is (d) the gradual and fitful creation of a political environment that provides a more congenial foundation for the development of advanced forms of capitalist accumulation. Out of societal conflict emerges fundamental change in the political sphere, which in turn facilitates the emergence of more 'rational' forms of capitalism. In short, economic expansion not only has the capacity to line the pockets of patrimonial officialdom and to enhance the political viability of patrimonial regimes, it can *also*, over the long run (and despite the best efforts of the officialdom), promote social changes so profound as to effectively challenge the very foundations of the patrimonial administrative state.

Indeed, recent works focus on the increasing assertiveness of the Indonesian and Thai bourgeoisies, and the recent tumult in Thailand—with the strong role played by business people and the middle class—confirms that new social forces have burst on to the political stage. In the process of social conflict, there is a clear diminution of the (patrimonially based) powers of the Thai bureaucratic elite.[25] The increasing strength of the Indonesian and Thai bourgeoisies has strong parallels in a process that took place in the development of European capitalism, when the domination of the 'political level' gave way to the domination of the 'economic level'. As Callaghy explains, the rising bourgeoisie began to demand less 'special protection and favor', and 'slowly and unevenly' rely more on the 'generalized presence' of Weber's preconditions to capitalist development.

> As this shift took place over time, key bourgeois elements began to *expect* a viable calculability nexus without having to 'pay' for it each time via patron–client ties and patrimonial administration, and they increasingly demanded it as their class weight, presence and power accumulated. (Callaghy 1988: 76)[26]

At the same time, one finds evidence of important change even within the bureaucratic elite itself. Particularly in Thailand it seems that elements of the old bureaucratic elite are beginning to be absorbed into the ranks of the bourgeoisie; as McVey points out, bureaucratic elites may become ever less reliant on the milking of office-based privileges, as they (and even more importantly, their children) have begun 'taking a serious and active role in business'. In effect, individual members of an old social force (the bureaucratic elite) may respond to changed structural conditions by gradually incorporating themselves and their children into a new social force (the rising bourgeoisie). In terms of concrete behaviour, this means that entrepreneurship based on rent-seeking behaviour becomes less important relative to entrepreneurship based on productive activity.[27]

The second broad type of patrimonial polity is the 'patrimonial oligarchic state', exemplified here by the Philippines. In this polity, access to the state remains the major avenue to private accumulation, but the dominant social force has an economic base largely independent of the state apparatus. As in all patrimonial polities there is weak separation between the 'official' and the 'private' sphere; unlike the patrimonial administrative state, however, the influence of extra-bureaucratic forces swamps the influence of the bureaucracy, and major power resides not in a class of officeholders but rather in the 'private sector'. To the extent that there is a central ruler, that person 'stands as one landlord . . . above other *landlords*'.[28]

The type of rent capitalism that corresponds to the patrimonial oligarchic state reflects the relative power of the state apparatus and business interests. In contrast to 'bureaucratic' capitalism, where a powerful bureaucratic elite is the major beneficiary of patrimonial largesse and exercises power over a weak business class, the principal direction of rent extraction is reversed: a powerful oligarchic business class extracts privilege from a largely incoherent bureaucracy. As noted above, we can call this 'booty capitalism' and distinguish it from the 'bureaucratic' capitalism' found in patrimonial administrative states.

In specifying the principal direction of rent extraction, of course, I am not denying that government officials in the Philippines often participate in the process of rent-seeking. Indeed, customs officials regularly extract bribes from smugglers, just as their higher-ups in the bureaucracy can extract 'consideration' from industrialists seeking more formalised—but still particularistic—benefits, such as protection from competition through import quotas. Other examples abound, whether in the allocation of logging concessions or in the allocation of selective credit. But the major beneficiaries of rent capitalism in the Philippines are not the bureaucrats who push the papers; they are rather the oligarchs who (from their extra-bureaucratic perch) cause the papers to be pushed. Unlike in Thailand or Indonesia, bureaucratic officials have never constituted a bureaucratic elite and have never become a powerful social force in their own right.

The weakness and incoherence of the postwar Philippine bureaucracy begins with the process by which bureaucrats are hired. Because the primary loyalty of government employees often remains with the patrons who got them the job in the first place, agency heads have little ability to command the obedience of their subordinates. The formal lines of demarcation among agencies are greatly undercut by the informal—yet powerful—ties of loyalty between political patrons and their clients in the bureaucracy. As a result the bureaucracy is highly splintered, and even coherent agency-based factions are often difficult to discern. In short, the Philippine bureaucracy not only lacks coherence *among* its various parts (a common malady of the clique-ridden bureaucratic polity), more fundamentally it also lacks coherence *within* its various parts.

The patrimonial oligarchic state is more resistant to reform than the patrimonial administrative state in two respects. First, piecemeal reforms (those which are merely intended to meet the political imperatives of regime preservation) are often inhibited by both the lack of bureaucratic coherence and the tremendous power of particularistic oligarchic interests. Although there are clearly instances when regime interests might benefit from selective measures of reform, there is little assurance that the weak bureaucracy (even if bolstered by infusions of technocratic expertise) can implement the measures over the objections of entrenched interests long accustomed to particularistic plunder of the state apparatus. The relative ease with which Suharto and his generals can achieve selective liberalisation contrasts greatly with the enormous obstacles to similar types of reform in the Philippines.[29]

Second, and more important, because it is unlikely to generate the emergence of new social forces able to challenge the patrimonial basis of power, booty capitalism is much more resistant to fundamental transformation than is 'bureaucratic' capitalism. Even when external forces help to finance the growth of a more modern and complex economy, there is little impact on the distribution of power within the polity. The Philippines received an even greater (and much earlier) external stimulus to its economy than did either Indonesia or Thailand, as foreign aid and foreign investment streamed into the country in the early decades of the postwar era. But this stimulus fell upon the rocky soil of the patrimonial oligarchic polity, and did not help to foster the emergence of new social forces. The major reason, quite simply, is that economic growth merely strengthens the oligarchic social forces that are *already* the major beneficiaries of patrimonial largesse. It does not, as in Thailand and Indonesia, encourage the creation of increasingly assertive new social forces.

In the midst of increasing economic complexity, no countervailing social force emerges to challenge either the patrimonial features of the political economy or the longstanding dominance of the oligarchy. Non-oligarchic social forces never seem to achieve the 'critical mass' necessary to force major overhaul of the system. First, small- and medium-scale capitalists are hard-hit by frequent balance-of-payments crises, and are therefore a weak constituency for the export-oriented, free-market economic reforms pushed by local technocrats and multilateral institutions (De Dios 1990: 140–1). Second, the potency of reformist zeal that might be found within the Philippine middle class is curbed by the huge exodus of migrants and skilled technicians to foreign lands. Third, revolutionary forces are hobbled by internal divisions, occasionally effective counter-insurgency drives and weak external support.

Moreover, there is little incentive for oligarchs themselves to press for a more predictable political order, because their major preoccupation is the need to gain or maintain favourable proximity to the political machinery. Even those oligarchs who are temporarily 'on the outer' exert far more effort in trying to restore such proximity than in demanding profound structural change. Far from being a 'container for fundamental transformation', the patrimonial oligarchic state and the booty capitalism that it engenders are a 'developmental bog' into which the Philippine nation has—despite its enormous resources and talents—sadly become mired. Even if the economy were to begin another growth spurt (fuelled, perhaps, by investment from its neighbours), there would likely be little change in the essential imbalance of forces within society. The major beneficiaries would be those who are *already* the hegemonic force within society.

When such external interests as US AID, foreign investors and multilateral institutions do occasionally press for fundamental change in administrative structures, they are not (as in Thailand and Indonesia) supporting an emerging business class with parallel demands; rather, they find only a weak domestic constituency for change. Over time, foreign capital found greener pastures in countries (such as Thailand and Indonesia) able to provide a more suitable political environment for their investments, and the major concern of external forces in the Philippines became ever more skewed towards strategic rather than economic interests. This weakened the potential leverage of the multilateral institutions even further, as their 'conditionalities' were commonly overridden by strategic considerations. Whereas external forces in Thailand and Indonesia seem to have provided an important stimulus for change, their major effect in the Philippines was to create and sustain a hothouse within which patrimonial features have flourished.[30]

CONCLUSION: PROSPECTS FOR FUNDAMENTAL TRANSFORMATION OF THE PHILIPPINE POLITICAL ECONOMY

What are the possibilities for thoroughgoing economic transformation in the Philippines? Without fundamental change in the nature of the state, I have argued, the country will be unable to move coherently along either of two major paths of economic development. Most obviously, the 'statist model' (of a high degree of state intervention in credit allocation, trade promotion etc., as found in South Korea and Taiwan) cannot be replicated by a state with such a fractured and ineffective bureaucracy. More fundamentally, however, the Philippine state is incapable of providing even the basic legal and administrative underpinnings necessary for the laissez-faire model which the IMF and the World Bank have long been peddling to the country. Overwhelmed by the myriad particularistic demands of powerful oligarchic interests, the Philippine state is unable to supply anything approximating the 'political and procedural predictability' necessary for the development of more advanced forms of capitalist accumulation. Until there is greater development of the state apparatus, oligarchy-dominated booty capitalism will continue to stunt the development of the Philippine economy. The diversified conglomerates of major oligarchic families will continue to dominate the economy, and the enormous talents of small- and medium-scale Philippine entrepreneurs will continue to be sorely underutilised.

The evolution of patrimonial features in both the Thai and Indonesian settings provides a clear contrast to the perpetuation of similar features in the Philippines. The polities of all three countries, of course, have been historically shaped in critical ways by external factors; the result in the Philippines, however, was a patrimonial oligarchic state that has shown itself particularly resistant to reform. Throughout the country's long colonial past there was far more oligarchy-building than state-building, and the state that emerged in the postcolonial era has depended upon external resources for its basic sustenance.

Unlike in Thailand and Indonesia, postwar foreign aid and investment have done little to encourage the transformation of the Philippine political economy. A major impact of external resources on the Thai and Indonesian bureaucratic polities has been to help fuel an economic growth that created new social forces; the emergence of these social forces, in turn, provides a clear basis for the kind of societal conflict that can induce major change in the political sphere. In the Philippines, however, external resources have been an obstacle—not a catalyst—for change in the prevailing social imbalance. The former colonial power provided counter-insurgency assistance that protected oligarchic plunderers from revolutionary upheaval, financed the perpetuation of the hothouse political economy within which patrimonial features flourished, and sheltered the country from any sense of external threat. Economic growth has not led to the creation of new social forces, and the result has been little change in the political sphere. Until new social forces emerge, there will be no conflictual basis for changes at the level of the state.

If the *presence* of external resources has had little transformative impact on the Philippine political economy, what might be the impact of their relative *absence*? As the United States withdraws its military bases from the Philippines, external resources have already begun to decline dramatically. The country is quite clearly at a crossroads. On the domestic front, there will no longer be an external guarantor for the continuation of the prevailing social imbalance within the Philippines. For most of this century the oligarchy's major external concern has been how to ensure continued US sponsorship for its domestic hegemony; in the future, however, the oligarchy will no longer enjoy such ready foreign support.

On the external front, cliental relations with the United States seem to have insulated Philippine elites from any real sense of intrastate competition—competition that has often been the historic starting point for serious state-building projects.[31] Until recently, the availability of external resources has greatly curbed any need for reform: the country's role as host of the US military bases has helped ensure repeated rescue from the balance-of-payment crises that have plagued the postwar economy. But with the withdrawal of the bases from the Philippines the country will face increasing pressure to begin to orient its economic system toward more internationally competitive modes of operation. Moreover, the country may have increasing need to protect itself against external threats.

Despite the fact that the country faces new external imperatives, it remains to be seen if there exists any group—within the state or within civil society—cohesive or powerful enough to begin to marshal the forces to meet them. The oligarchy-dominated bureaucracy is even more splintered than the traditional bureaucratic polity, and its capacity to coordinate an effective response remains quite limited. Although individuals within the state apparatus understand the imperatives for reform, they lack the power to implement even the most basic reform agendas. Within the oligarchy itself, loyalty to family generally continues to overshadow loyalty to nation. To the extent that networks of cooperation are built among oligarchic forces, the result is far more likely to be economic collusion than reform of the national economy. Unfortunately, it is also difficult to conceive of any new social force emerging in response to new imperatives in the international environment. The hegemony of the oligarchy seems quite secure at present, as neither the professional middle class, small- and medium-scale entrepreneurs, nor popular forces seem at all poised to challenge their dominance.

Even if external resources were to dry up, there may be little short-term impact on basic patterns of interaction between the patrimonial state and the predatory oligarchy. External resources can perhaps best be viewed as an enabling condition: they have insulated the state from external pressures and guaranteed the domestic hegemony of the oligarchy. The sudden withdrawal of these resources, however, would not automatically disable the system of booty capitalism, because one should expect no fundamental change in the political economy until non-oligarchic groups have enough social weight to challenge the oligarchy's hegemony. The reduction of external resources may serve as an important catalyst for major shifts in the internal balance of social forces, but it is likely that the shifts themselves will occur only gradually and fitfully. In other words, there may be a substantial time lag between changes in the international environment and the transformation of domestic social and political structures.

It is entirely possible, for example, that oligarchic plunder of the state apparatus could endure long after the pie of plunder shrinks—booty capitalism could survive even as the amount of available booty declines. In such a scenario the state apparatus would remain woefully underdeveloped, and there would continue to be a high degree of arbitrariness in the political sphere. If Weber is correct, the emergence of modern, rational capitalism is likely to depend on the prolonged, turbulent process of dismantling the oligarchy's control over the state and building a state that is able to provide some greater measure of calculable adjudication and administration. State-building arises out of a long historical process; in the Philippines, it seems, the imperatives that force such a process are only now beginning to be felt.

NOTES

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2 Weber (1978, vol. 2: 1041). For a more complete discussion of the

applicability of the patrimonial framework to the postwar Philippines (before, during, and since the martial law eras), see Hutchcroft (1991).

3 Weber (1978, vol. 2: 998). Theda Skocpol defines state autonomy as situations in which 'states conceived as organizations claiming control over territories and people may formulate and pursue goals that are not simply reflective of the demands or interests of social groups, classes, or society' (Skocpol 1985: 9). In polities with strong patrimonial features, there is by definition a weak separation between the 'private' and the 'official' sphere, and therefore a particularly weak degree of autonomy. See Weber (1978, vol. 2: 1028).

State capacity, Kathryn Sikkink writes, 'involves the administrative and coercive abilities of the state apparatus to implement official goals' (Sikkink 1988: 3). In polities with strong patrimonial features, allegiance to 'official goals' is commonly swamped by allegiance to personal goals.

4 Evans describes Korea and Taiwan as 'developmentalist states' enjoying 'embedded autonomy'. He explains that 'the combination of historically accumulated bureaucratic capacity and conjuncturally generated state autonomy put these state apparatuses in a very exceptional position'. (Evans 1989: 575; Haggard & Cheng 1987: 128.)

5 Andreski (1983, vol. 9). My definition of 'rent capitalism' is taken from Andreski's definition of 'political capitalism'. This definition has clear parallels with those which define 'rent-seeking' as a 'directly unproductive profit-seeking (DUP) activity' (Colander 1984: 6). Similarly, Buchanan uses the term rent-seeking 'to describe behavior in institutional settings where individual efforts to maximize value generate social waste rather than social surplus' (Buchanan 1980, vol. 4).

6 At the level of the firm, Krueger explains, 'rent-seeking is one part of an economic activity, such as distribution or production, and part of the firm's resources are devoted to the activity' (Krueger 1974: 293). Similarly, at the level of the overall political economic system, rent-seeking is only one part of economic activity. Where it is relatively more prevalent, we can speak of rent capitalism; where it is relatively less prevalent, we can speak of production-oriented capitalism.

7 As Montes points out, in the Philippines this 'property' can include 'protection from competition through quotas, tariffs, and measured capacities, subsidized credit, access to foreign reparations, loans, and grants'. Those who gain such 'property' need not develop it; rather, 'they only need to maintain their influence over people in the government machinery to maintain and expand their ownership of economic advantages' (Montes 1988: 65–66).

Montes' categories closely parallel my categories of 'production-oriented capitalism' and 'rent capitalism'. The major difference, however, is his assertion that a rent-seeking economy 'cannot readily be classified as capitalist' (p. 65). In his analysis, the Philippines suffers from a 'feudal social basis of political power' (Montes 1989: 135). If Weber is the guide, however, the economy of the Philippines *is* capitalist, not feudal (and its polity is patrimonial, not feudal). In Weber's classification an economy can be teeming with unproductive activity and still be considered 'capitalist'—albeit of a particular type.

8 Krueger, like Montes, does not focus attention on the direction of rent extraction. She does, however, note that rents are extracted by both business people and bureaucrats (Krueger 1974: 292).

9 My use of the term 'booty capitalism' to describe a subtype of rent capitalism is not unlike Weber's use of the term to describe a subtype of 'politically determined' capitalism. While he seemingly used the term 'booty capitalism' to describe the gains of war, however, I am using the term to evoke an image of the plunder of state resources by social forces which have a firm economic base outside the state. The competition among oligarchs for the booty of state is often violent, and (as is explained below) the system has ultimately been supported by an external military power. Although my use of the term 'booty' likely involves a more systematic source of gain than Weber had in mind, it is certainly not inconsistent with the *Random House Dictionary's* definition: '1. loot or plunder seized in war or by robbery. 2. any prize or gain'.

The term 'bureaucratic' capitalism is derived from the widespread use of the term 'bureaucratic polity'. It does not, of course, connote the presence of a bureaucratic state in the Weberian sense, and it is for this reason that I place the word 'bureaucratic' in quotation marks.

10 For a detailed analysis of the formation and persistence of these diversified family conglomerates, see Hutchcroft (1993, chapter 3). There I demonstrate the centrality of the political machinery to familial strategies of wealth accumulation, and argue that the inability of the Philippine state to formulate or implement a coherent policy of economy development must be examined alongside the systematic plunder of the state apparatus by diversified family conglomerates. In fact, only by understanding the internal logic and *coherence* of familial strategies of patrimonial plunder can we fully understand the continuing *incoherence* of national development strategies.

11 As Aristotle wrote, 'where men rule because of the possession of wealth, whether their number be large or small, that is oligarchy'. Unlike an aristocratic system, there is little stability in the composition of an oligarchy, as there is a constant stream of new entrants as new wealth is created. As a system of government, oligarchy is rule 'for the benefit of the men of means' not rule for the 'common good' (Aristotle 1985: 192, 190; see also pp. 252–60). (Thanks go to Jim Nolt for introducing me to basic elements of Aristotelian thought.)

Moreover, the fluid composition of the upper reaches of Philippine society displays (once again) how the term 'patrimonial' is far more appropriate than the term 'feudal' in describing important characteristics of the Philippine political economy. As Weber explains: 'Patriarchal patrimonialism is much more tolerant than feudalism toward social mobility and the acquisition of wealth. The patrimonial ruler does not like independent economic and social powers . . . but he also does not support status barriers' (Weber 1978, vol. 2: 1102).

12 This point draws on an incisive analysis of post-colonial African states (Jackson & Rosberg 1982). Their analysis helps us to understand why certain Third World states (including the Philippine state) endure despite both their lack of an effective monopoly over violence and taxation and their inability to maintain control over much of their territory.

13 *Philippine News* (San Francisco), 8–14 July 1992, p. 14. Ramos blames 'the entire regime of regulation and control' for these distortions; as this chapter argues, however, the problem is better characterised as ineffectual and inconsistent regulation of capital, and inadequate control of the powerful social forces who 'extract wealth without effort'. Until such regulation and control can be effected, laissez-faire prescriptions will continue to go nowhere.

14 As Evans suggests, in order to explain critical differences among state apparatuses it is necessary to understand the 'historical traditions [and] specific class configurations out of which they arise' (Evans 1989: 562, 583).

15 Phelan explains that 'the conquest was facilitated by the fragmentation of Philippine society', and 'the occupation of the Philippines was essentially a missionary enterprise'. In fact 'the vast majority of Filipinos in the provinces seldom saw any Spaniard except the local priest' (Phelan 1967: 13, 15, 131).

16 Anderson goes on, its 'economic base lay in hacienda agriculture, not in the capital city' (Anderson 1988: 9–12). See also Corpuz (1957: 249).

17 Doeppers (1984: 2, 62, 139–40, 72; quotes from 2, 62); drawing on Evers 1966.

18 Valdepeñas & Bautista (1977: 114–15); McCoy (1983: 139–44). The American market offered similar advantages to the Philippine coconut industry (Hawes 1987: 60–1, 86–9).

19 Joint Philippine–American Finance Commission (1947: 3). The commission's report also notes that despite 'heavy physical devastation' and 'the low output of several basic industries', a high level of US government spending and assistance enables the country to enjoy 'abundant dollar resources, a stable currency, and a flow of imports which is unrestricted and in greater volume than ever before in its history'.

20 Golay (1961: 71–2, 80). The near-collapse of the state came not only from its inability to extract revenue from the oligarchy, but also from its lack of tariff autonomy vis-a-vis the former colonial power. In order to acquire postwar rehabilitation assistance and safeguard their access to the protected American market, the oligarchs bargained away fundamental chunks of the country's economic sovereignty. See Hawes (1987: 28–30, 89–90).

21 A fuller comparative discussion of patrimonial polities and rent capitalism is to be found in Hutchcroft (1993: chapter 2). The term 'patrimonial administrative state' comes from Callaghy (1984).

22 Crouch (1979: 579, 582–3; quotes from 579, 582); see also Heydemann (1992), discussing recent 'selective stabilization' measures in Syria.

23 Both Crouch and McVey discuss the centrality of externally generated

resources in bringing about the emergence of more modern and complex economies. 'In contrast to traditional patrimonial states, which acquired funds largely through the exploitation of the peasantry and through wholesale trade, the New Order has depended on a rapidly expanding modern economy financed by foreign aid, foreign investment, and rising oil prices' (Crouch 1979: 579). Similarly, McVey notes that 'Thailand's leap forward of the 1960s was fuelled in good part by capital injected into the country by the United States in connection with the Vietnam war'. In later years, investment from Japan and the NICs has flooded into Thailand (McVey 1992: 30). The external stimulus seems to have been a critical element of the process of economic growth, but other factors were also of course very important. In both Indonesia and Thailand, political elites implemented a range of policies to stimulate economic growth (and thereby help to ensure the long-term political legitimacy of their regimes).

24 As McVey explains, 'foreign interests have helped to protect domestic capital from the state' by providing funding and support to those opposing practices that are inimical to business. In Thailand, success in industrial ventures was 'accomplished by "new men" in the Thai business world who obtained backing from foreign interests'. In Indonesia, as well, foreign investors helped at times to strengthen business elements who were out of favour politically (McVey 1992: 29–30).

External firms, of course, cannot always be counted on to support the regularisation of relations between government and business. Just as domestic capital can, foreign capital can purchase a 'viable calculability nexus' (Callaghy 1988: 76) with a patrimonial state by cultivating relations with the proper officials, and if this nexus is working quite suitably (and remains essentially undisturbed by regime change) there is little reason for external firms to use their influence to challenge the patrimonial political order. Because a more nearly bureaucratic political order is much more likely to provide a calculable environment for the investments of individual firms, however, one can expect that foreign capital, in general, will support the regularisation of relations between government and business. The firms are unlikely to lead the charge, because their primary goal is not political reform but profit maximisation. But if their domestic allies are ardent reformers, one can expect them often to be 'a powerful ally in lobbying against policies and practices hostile to business' (McVey 1992: 29).

25 Examples of recent works charting the increasing assertiveness of the bourgeoisie in Thailand and Indonesia are noted in the introduction. In addition, while Lev deals little with the business class *per se*, he offers an excellent analysis of 'efforts to establish an Indonesian "law state" in the context of middle-class assaults on patrimonial assumptions of political order' (Lev 1978: 37).

26 See also Crouch (1979: 582). While this shift is beginning to be apparent in Indonesia, and is most obvious in Thailand, it is by no means inevitable that a patrimonial administrative state will undergo this process of

self-destruction. The patrimonial administrative state *may* become a 'container for fundamental transformation', but it is not inevitable that one will observe the growth of a new business class able to rise up and challenge the exactions of the patrimonial officialdom. See the discussion of Zaire in Hutchcroft (1993: chapter 2).

27 As McVey notes: 'It is still early days for most Southeast Asian politico-bureaucrats turned businessmen, and it is still difficult to see where the line between rent-seeking and real entrepreneurship has been crossed, and whether investment in new enterprise is spurred by speculation or prestige-seeking rather than a serious aim at development . . . [But] we can see signs of the gradual crystallization of entrepreneurial attitudes, a shift in weight from bureaucratic and political to business values, and the emergence of more long-term commitment'. McVey (1992: 23–4, 26).

28 As Weber goes on, where local administrators are able to develop their own 'military and economic power', it 'soon tended to encourage the administrator's disengagement from the central authority'. Local landowners could also gain relative autonomy within their area of control, and become 'local patrimonial lords' with their own arbitrary powers over their subjects (Weber 1978, vol. 2: 1055, 1044, 1059; see, in general, pp. 1051–9).

29 On a comparative basis, it seems that Suharto found it easier to force through liberalisation measures than did his counterparts in Thailand, and the Thai bureaucrats found it easier to force through liberalisation measures than did their counterparts in the Philippines. As Doner and Anek show, it is important to differentiate between the Thai and Indonesian cases, because efforts at selective liberalisation undertaken by political elites in Thailand have had to contend with a much stronger private sector than exists in Indonesia. See Doner, Richard F. & Anek Laothamatas (forthcoming), 'The political economy of structural adjustment in Thailand', World Bank Working Paper.

Even during martial law, when Marcos placed technocrats at the helm of key economic policy-making agencies, the political logic of cronyism placed major obstacles in the path of serious reform. While technocrats helped the regime to secure funding from multilateral agencies, their advice was commonly ignored. See Hutchcroft (1991: 428–45).

30 It is not surprising, then, that many still find dependency theory (and popularised versions thereof) a convincing 'explanation' of Philippine underdevelopment—even though its basic premises are clearly contradicted by cursory comparative examination. It is obvious to most students of comparative political economy that other East and Southeast Asian countries that used to be similarly 'dependent' have since managed to carve out stronger roles for themselves. But for those who do not think comparatively, the fact remains that external forces and external resources have done little to promote successful economic development in the Philippine context; external factors are thus seen as the 'cause' of the country's economic woes. Indeed, neither the United States (the former colonial power) nor the IMF and the World Bank (so-called 'agents of

neo-colonialism') have much reason to be proud of their overall influence on Philippine economic development. They have done far more to prop up unproductive social forces than to generate conditions conducive to the emergence of productive capitalism. While the present analysis places great emphasis on the role of external forces in shaping and maintaining the patrimonial oligarchic state, it recognises that external forces have widely diverging impacts on developing countries. Whereas dependency theory expects international capitalism and the international multilateral institutions to have a detrimental impact on developing countries, the present analysis anticipates that the impact will vary greatly—depending largely on the nature of the state and social structures into which external forces are introduced.

31 Migdal, for example, writes that 'a prime motivation for state leaders to attempt to stretch the state's rule-making domain within its formal boundaries, even with all the risks [that] that has entailed, has been to build sufficient clout to survive the dangers posed by those outside its boundaries, from the world of states' (Migdal 1988: 21).

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9 Power, Prosperity and Patrimonialism: Business and Government in Indonesia

Andrew MacIntyre

Indonesia has experienced strong economic growth for over twenty-five years now. Having seemed beyond economic redemption in the mid-1960s, it has emerged to become a favourite child of the World Bank. Indonesia's per capita GNP growth between 1965 and 1990 (4.5 per cent) well exceeded the average for middle- and low-income countries (2.2 and 2.9 per cent), and even surpassed that of the other high-growth Southeast Asian economies, Malaysia (4.0 per cent) and Thailand (4.4 per cent) (World Bank 1992a: 218–19). In the second half of the 1980s Indonesia began a process of major structural adjustment, adopting more outward-looking economic policies which have seen labour-intensive industries manufacturing for export flourish. Indonesia has, in short, been making very solid economic progress on a sustained basis.

Not surprisingly perhaps, this has invited comparisons with the experiences of ultra-high-growth Northeast Asian NICs (newly industrialising countries) such as South Korea and Taiwan. However, while there are indeed some important similarities, it would be misleading to present Indonesia as replicating the patterns of business–government interaction associated with the so-called capitalist developmental states of Northeast Asia (Johnson 1987; White 1988, Wade 1990; Haggard 1990; Onis 1991). Although Indonesia has been ruled by the authoritarian Suharto regime since the late 1960s the state has not been 'strong' or 'hard', but has been infused with patrimonial distributional networks linking officials and business people. And although the state has played a very active role in seeking to sponsor industrial development, economically interventionist policies have generally not yielded great fruit; indeed in recent years the state has been retreating to more orthodox liberal economic policy positions. Having been overshadowed by the state for many years, private industry is now coming to the fore in Indonesia. This is very apparent in economic terms, but we are also beginning to see it reflected in more strictly political interaction between business and the state.

In exploring these issues this chapter will begin by focusing on the record of state domination of economic and political life in Indonesia, and on the ways in which private entrepreneurs have responded to this. Attention will then be directed to trends emerging in the later 1980s in Indonesia's political economy which have seen the rise of the private sector and the 'retreat' of the state. Finally, the pattern of relations between business and government in Indonesia will be contrasted with those in other Northeast and Southeast Asian countries, with consideration being given to the implications of Indonesia's blend of limited state capacities and pervasive patrimonialism for the future pace of industrialisation.

STATE DOMINATION AND INTERVENTION

The most fundamental feature of Indonesia's political economy is that until very recently the modern private sector (as distinct from state-owned enterprises, cottage industries and petty traders) has been largely overshadowed by an interventionist state—both in commerce and in politics. In economic terms, the Indonesian state has been strikingly interventionist. The country has a long tradition of economic nationalism, with the state seeking to guide and manage local industrial development rather than rely upon the uncertainties of market forces. In terms of the political environment, business in Indonesia has had to operate within a decidedly authoritarian framework. Although the drift towards authoritarianism began in the late 1950s with Sukarno's introduction of 'Guided Democracy', it is under Suharto's military-based 'New Order' regime (beginning in 1966 and continuing to the present) that state control of political participation has become institutionalised in a systematic fashion. Importantly, authoritarian corporatist structures introduced by Suharto over the past two decades have served effectively to contain and restrict industry politically, minimising the scope for collective action. Among other things, this has contributed to the persistence of patrimonialist, or clientelistic, connections as the principal mechanism for the advancement of business interests in the policy process.

By comparison with the other industrialising market economies of Northeast and Southeast Asia examined in this volume the Indonesian state has, as noted, played a remarkably interventionist economic role.

One factor contributing to Indonesia's tradition of state interventionism was the country's long colonial experience and armed struggle for national independence in the late 1940s. Several centuries of Dutch domination engendered an enthusiasm among nationalist leaders for anti-capitalist ideas and a profound scepticism of liberal economic thinking: capitalism was loosely equated with colonialism and exploitation. This resulted in the widespread popularity of collectivist ideas about economic organisation, and a deep suspicion of the so-called 'magic of the market-place' and foreign investment. Indeed, enshrined in an often-quoted section of Indonesia's Constitution (section 33) is the proposition that economic activity should be organised on the basis of joint endeavour and that the state should control key sectors of the economy for the benefit of the people (Liddle 1982; Rice 1983).

Beyond ideological considerations, a further historical factor contributing to the tradition of extensive state intervention in the economy was the simple reality that Indonesia commenced life as an independent nation state with a puny local business class. The Republic of Indonesia was born with a classic colonial economy based on plantation estates producing for export. The most elementary obstacle to government efforts to foster greater national economic self-sufficiency was that there was little in the way of a modern business class beyond petty merchants and a declining collection of regional traders. Moreover, the local business community (such as it was) was overwhelmingly made up of Chinese rather than indigenous Indonesians. As in other parts of Southeast Asia (see chapters 6 and 7) the immigrant Chinese trading communities were the focus of disdain and resentment by the indigenous population, almost all of whom worked either as peasants or in the colonial and feudal bureaucracies. In Indonesia, indigenous mistrust of the 'alien' immigrant Chinese was heightened by the wide gulf between Confucianism and Islam, as well as by the fact that the Chinese were popularly perceived to have been commercial middlemen for the Dutch during the colonial period. Consequently, although the Chinese dominated local commercial activity they were political outcasts. Indigenous resentment of Chinese Indonesians (who amount to less than 5 per cent of the population) has been a fundamental and enduring factor shaping the relationship between business and government in Indonesia. Political leaders have long believed that the state must intervene in the operations of the marketplace to ensure that a satisfactory share of economic benefits is enjoyed by the indigenous majority.

For a variety of reasons, then, it was generally agreed among the political elite that the state would, of necessity, have to take an active developmental role. A range of measures were adopted in the late

1940s and early 1950s to foster local industrial development. In the banking sector, a former Dutch bank was made into the central bank and several state-owned developmental banks were established to nurture local industry with preferential lending schemes (Paauw 1960). State banks also supported the development of a range of state-owned enterprises (SOEs) in industries such as cement, textiles, glass and automobile assembly. In addition to these operations in the manufacturing sector, the state took charge of various utilities, including ports, railroads, postal and telegraph services and coalmines, and attempted to compete with the Dutch trading companies (which continued to operate in Indonesia after independence) by creating a state-owned import–export company (Robison 1986: 40). However, of all the numerous state initiatives designed to accelerate the development of local business, the highest profile one was the *Benteng* Program. Beginning in 1951, this program was designed to foster indigenous entrepreneurs through a system of allocating import licences. In practice, as in so many other cases, problems of policy implementation undermined this initiative; rather than using the import licences as an instrument for longer term capital accumulation, the indigenous recipients opted for short-term profit taking and resold the licences to well-established Chinese Indonesian entrepreneurs (Robison, 1986: 44–5).

For most of the 1950s, economic policy making was hostage to the vagaries of a fledgling and highly fluid multi-party system of parliamentary democracy (Feith 1962). The fact that the institutions of representative democracy were not well established meant that (as in many other developing countries) individual patron–client relationships remained a dominant mode of political participation. Moreover, in a situation where the state was doling out subsidies of one sort or another, aspiring business people were assiduous in cultivating personal alliances with key parties, politicians and bureaucrats. As elsewhere in Southeast Asia, this was particularly true of Chinese Indonesian entrepreneurs who individually and covertly sought the protection and patronage of highly placed indigenous politicians and officials in return for cash and shares, seats on their boards of directors, or joint venture activities with family members of the indigenous patron.

Beginning in 1957 Indonesia moved into a period of major change known variously as the 'Guided Democracy' or 'Guided Economy' years. Following the breakdown of the system of parliamentary government and the outbreak of regional rebellions, President Sukarno used the support of the military to declare martial law and returned the country to an earlier constitution which centralised power around the presidency. This was the beginning of a long-term shift to authoritarianism. There were dramatic changes in economic policy as well, as Sukarno embarked on a nationalist crusade. In the late 1950s Sukarno confiscated all Dutch assets and effectively terminated direct foreign investment outside the oil and resources sector. Importantly, control of the former Dutch firms was not transferred to local entrepreneurs (as happened, for example, with former Japanese plants in South Korea); instead it was decided that they would be run as SOEs. In most cases management of the Dutch firms was taken over by members of the armed forces. There were a number of reasons for this. At an immediate level, maintaining the former Dutch firms as SOEs presented the government with a valuable tool for patrimonial politics; the SOEs were cash cows producing rent-taking opportunities for those fortunate to be appointed as managers. In addition, however, it was well recognised that the alternative to state control—privatisation—was politically untenable as it would effectively mean handing the former Dutch firms to Chinese Indonesians. More broadly, the idea of the state managing the nationalised Dutch firms was in keeping with the quasi-socialist character to economic policy that emerged under Sukarno.

Between 1957 and 1966 (when he fell from power) Sukarno undertook an intensive and chaotic state-led drive for import-substituting industrialisation. The range and number of SOEs grew rapidly, funded by heavy foreign borrowings and revenue from the oil industry. To facilitate Sukarno's ambitious 'Guided Economy' strategy, the banking system was restructured and brought under close government control, with credit being channelled strongly towards the rapidly expanding state sector (Arndt 1971). Although access to credit became increasingly tight for private borrowers, a number of indigenous Indonesian business people succeeded in expanding their operations on the basis of preferential treatment by sympathetic government officials. With the dismantling of parliamentary democracy, political parties declined in importance as vehicles for the advancement of business interests and individual clientelistic relations between entrepreneurs and senior civilian and military officials became all-important (Robison 1986). Commercial success was closely correlated with the position of a business person's patrons in government. Firms grew largely on the basis of preferential government treatment: those which had access to subsidies and various rent-taking opportunities were able to accumulate the capital necessary for further expansion.

By the mid-1960s it was clear that Sukarno's unbridled statist economic adventures were leading to disaster. Export earnings slumped, the large SOE sector was beset with widespread problems of corruption and inefficiency and the country found itself increasingly unable to service its foreign debt obligations. The slide towards economic crisis was accelerated by runaway inflation as the government resorted to printing money. In the midst of these grim economic conditions a political crisis erupted in 1965, when an unsuccessful coup attempt triggered a series of events which resulted in the military gaining control of government and General Suharto replacing Sukarno as President. The new regime brought a sharp reversal of the leftward swing of politics under Sukarno. Desperate to rehabilitate the country's economic fortunes, Suharto installed a group of Western-trained economists from the University of Indonesia in key economic ministries. With the support of the International Monetary Fund, the World Bank and other international creditors, the economists argued successfully for the introduction of a stabilisation program and the liberalisation of economic policy. Spending on SOEs was cut back, trade barriers were loosened and investment laws were overhauled in a bid to attract foreign capital back to Indonesia. This more outward-looking and orthodox liberal policy orientation did not, however, prevail for long. Within a few years, interventionist thinking was again ascendant.

The immediate cause of the resurgence of interventionist economic policies was the dramatic OPEC-led increase in international oil prices in 1974 (and again in 1978). The massive increase in tax receipts from the petroleum industry undermined arguments for conservative fiscal policies and opened the possibility of a renewed state-led drive for industrial development. The position of the interventionists within the government was further strengthened by popular opposition to the moves to woo foreign capital, culminating in what became known as the Malari riots which occurred during a visit by Japanese Prime Minister Tanaka in 1974.

Although the oil-led resurgence of economic interventionism did not amount to a return to the extreme *dirigisme* of Sukarno, it dispelled any illusions that Suharto's New Order regime was committed to liberal economic principles. As Hill (1994: 62) puts it:

> It is . . . a mistake to view the change in regime in 1966 as a switch from a 'socialist' to a 'capitalist' or 'free market' regime. There remains a deep-seated mistrust of market forces, economic liberalism, and private (especially Chinese) ownership in many influential quarters in Indonesia.

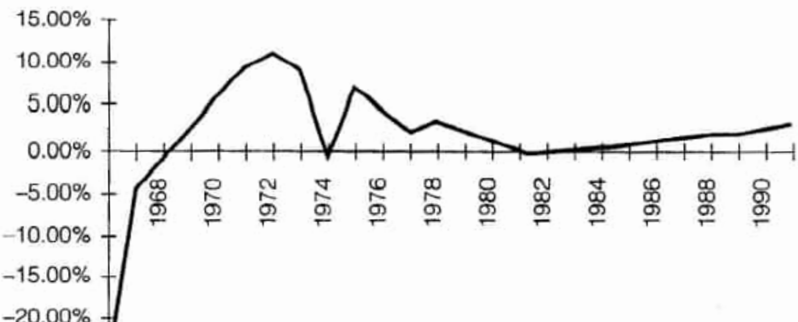
The pervasiveness of state intervention can be illustrated by focusing on several indicative areas: support for SOEs, intervention in financial markets, and shifts in trade and investment policies. In the case of SOEs, the impact of the oil boom is stark; the scope and extent of government spending on SOEs began to increase rapidly. The oil boom, it must be understood, was fundamental to Indonesia's political economy in the 1970s and early 1980s. By 1981 oil (and gas) accounted for 82 per cent of all exports and 73 per cent of government tax revenue. Accordingly, the 1970s and early 1980s saw a very sharp increase in real government income and expenditure (Booth 1992: 4, 24). One consequence of this was that the government could now contemplate accelerating and steering the process of industrialisation by investing directly in key industries rather than relying on the hope that private entrepreneurs would (eventually) invest resources in this fashion. Huge sums were pumped into SOEs in such industries as steel, fertilisers, aluminium, oil and petrochemical refining, paper and cement. In 1972 government investment in the SOE sector stood at Rp 23 billion; by 1976 this had risen almost ten times to Rp 218 billion, and by 1983 more than twenty-five times to Rp 592 billion (Hill, 1994: 71).

A comparable picture emerged in the banking sector and the operation of financial markets. Not only was the banking sector overwhelmingly dominated by state banks, the overall pattern of bank lending was heavily influenced by government intervention. The central bank operated direct and indirect preferential lending programs under which subsidised credit was supposed to be channelled to priority sectors of the economy. During the 1970s and early 1980s, the various subsidised lending programs amounted to a massive 50 per cent of all bank lending in Indonesia (MacIntyre 1993). One element of this enormous preferential lending system was a nominal bias in favour of indigenous Indonesian borrowers. Firms run by Chinese Indonesians that sought bank finance were forced to navigate their way around and through the maze of state regulations governing bank lending.

The foreign investment regime provides another clear illustration of a resurgence of state interventionism in the early 1970s. The pro-foreign investment attitude of the late 1960s began to wane in 1973, and then, following the Malari riots of 1974 and the sharp oil price rise, swung right around. Restrictions on the conditions of entry by foreign firms were steadily tightened, with more and more sectors being declared off-limits and the requirements for transferring control to local partners more taxing. This trend intensified following the second oil price hike in 1978. As Figure 9.1 shows, the impact of formal and informal barriers to foreign investors during this period is quite apparent: after initially crashing in 1974, net foreign investment declined steadily as a proportion of total investment through the later 1970s and early 1980s. Nationalist economic thinking also came to govern trade policy once again. Import restrictions began to increase once more with the renewed emphasis on protecting and nurturing local industry. Protection rates were high for importable goods and generally low or even negative for exportable goods. The proliferation of tariff and especially non-tariff barriers intensified in the wake of the second oil boom, with coverage being extended to an ever-longer list of manufacturing and raw material processing industries. Particularly restrictive was the practice in the early 1980s of allocating monopoly import licences for key industrial inputs to the politically favoured (Booth 1992: 25).

If the state has intervened extensively in the market, seeking to guide and accelerate economic development, it has also been deeply involved in attempting to structure and control political life. This has had profound implications for the way in which firms have sought to deal with government and influence the policy process. The crucial factor here has been the movement towards an increasingly authoritarian political framework following the failure of parliamentary democracy in Indonesia during the 1950s. The movement towards more authoritarian political structures intensified with the rise of the New Order regime of former General Suharto, in 1966. Following the widespread political mobilisation and enormous upheaval surrounding the demise of the country's first President, Sukarno, Suharto and his security advisers moved steadily to implement a corporatist strategy for political containment. The key to this strategy was the weakening and sidelining of the political parties and the channelling of political

Figure 9.1 Direct foreign investment as a proportion of total investment, Indonesia 1966–1991



Source: IMF International Financial Statistics participation into a network of state-sponsored corporatist organisations. Corporatist-style political representation was not new to Indonesia: a number of corporatist structures had been established in the 1950s and 1960s. Not surprisingly, the military was attracted to this model of political organisation for it increased the scope for state management and control of political action (Reeve 1985; MacIntyre 1991).

This corporatist strategy for political containment was extended across the political spectrum during the 1970s, with the state either establishing new organisations or designating existing ones as the official representative body for particular functional categories. The extensive network of corporatist organisations was designed to facilitate state control by ensuring that societal demand-making was contained within largely compliant representative organisations. The overall character of this corporatist system was authoritarian, comparable to the 'exclusionary' style of corporatist arrangements that Alfred Stepan (1978) identified in Peru.

Business representative bodies have not been as closely monitored or tightly controlled as have labour organisations, but there is little doubt that they have generally operated as instruments of the state rather than as vehicles for the advancement of business interests. The national Chamber of Commerce and Industry (KADIN) has long been a tame and formalistic institution, headed by individuals deemed acceptable by the government. These have included former military officers, retired bureaucrats and business people known to be closely linked to the government. In return for their cooperation, leading figures in KADIN have been secure in the knowledge that their firms will receive preferential treatment when tendering for government contracts, seeking concessional finance and such like. While KADIN may be an avenue for patronage for its leaders, it has been of little value to the broad business community in promoting business concerns with policy makers. Indeed, it is not only the business community that views KADIN with disdain; senior officials in the key economic ministries have generally disregarded it altogether in developing and implementing policy.

Beneath KADIN there is an extensive network of several hundred sectoral or industry-specific business associations which, in many cases, are small scale versions of the peak body: formalistic and tame in political terms (MacIntyre 1991). A further important ingredient that has undermined the political standing of business associations is that the leading Chinese Indonesian corporate groupings have tended to avoid serious involvement, particularly at the peak level. This reflects the longstanding pattern of Chinese Indonesian business people seeking determinedly to keep a low political profile in order to minimise the risk of provoking indigenous complaints about Chinese economic dominance.

One consequence of Indonesia's state-structured and highly restrictive political framework is that it has encouraged traditional patrimonial or clientelistic patterns of political participation to endure within the business community.[1] Personal relationships between individual business people and senior political figures have continued to be the dominant pattern of interest intermediation. Leading firms in Indonesia have had little incentive to contemplate collective action in seeking to influence the prevailing policy environment, for they have been able to obtain satisfaction from the state on the basis of personal bonds with power brokers. Rather than committing money and time in invigorating industry associations (which have been largely co-opted by the state) or investing in close links with political parties (which have been of little consequence in policy terms), they have relied on covert personal connections.

Firms favoured by the government were able to expand very rapidly, assisted in part by the extraordinary opportunities for rent-taking created by interventionist economic policies. As Robison (1992: 70) puts it:

> For most domestic corporate groups . . . the springboards to business success were the state-allocated monopolies, which gave access to crucial sectors of economic activity. Forestry concessions, import licenses, distributorships for basic commodities and contracts for construction and supply were allocated by the state, and the most successful capitalist groups were those that were able to gain access to these.

Patrimonial ties between key government figures and company heads were crucial to corporate success. Business people who had prospered in the 1950s and 1960s on the basis of clientelistic links with Sukarno's regime mostly fell from prominence under Suharto's New Order. The corporate stars of the 1970s and 1980s were those personally associated with Suharto himself or those immediately around him. Significantly, despite official rhetoric emphasising the government's determination to promote indigenous Indonesian entrepreneurs, the leading business figures were all Chinese Indonesian. Prominent examples include Liem Sioe Liong (Salim group), William Soeriadjaya (Astra group), Bob Hasan (Hasan group), Prajogo Pangestu (Barito Pacific group), Goh Swie Kie (Gunung Sewu group) and Tan Siong Kee (Roda Mas group) (Robison 1986; Yoshihara 1988; Shin 1989; Mackie 1992). In the 1980s, several young indigenous Indonesian business people rose through the corporate hierarchy at an astronomic rate: Bambang Trihatmodjo (Bimantara group), Hutomo Mandala Putra (Humpuss group) and Siti Hardijanti Hastuti (Citra Lamtoro Gung group). The common link was their father; these were sons and a daughter of Suharto. Even more clearly than the spectacular corporate empires developed in the 1970s by Chinese Indonesian entrepreneurs (such as those listed above), the business careers of the Suharto children highlight the fundamental importance of clientelistic connections as the key to gaining access to state-generated rent-taking opportunities and thence to commercial success.[2]

Some business people enjoyed such close—almost institutionalised—links with the President during the 1980s that this in itself served to attract other local and foreign firms to them. Given that only a limited number of business people could get close personally to the President, partnerships with those who were in this fortunate position became highly sought after. A reputation for impeccable patrimonial connections is thus an extremely valuable commercial asset itself, enabling the best-connected of business people to become proxy political patrons themselves.

THE UPSURGE OF INDUSTRY AND RETREAT OF THE STATE

As indicated earlier, the most distinctive features of Indonesian political economy over the last several decades have been the state's very extensive intervention in the economy and its domination of political life. These have plainly been determining aspects of the nature of the relationship between business and the state. Recently, however, important changes have been emerging. One is a process of 'strategic retreat' by the state: as part of a major reorientation of economic policy in the mid-1980s the state has been drawing back from a number of its strongly interventionist practices. At the same time the private sector has come to overtake the state as the dominant economic sector and, further, some sections of private industry are beginning to develop a collective political voice.

There have been a number of factors at work here. The strategic retreat of the state arises from the adoption of a range of neo-liberal-style economic policies during the later 1980s. This was part of a broad program of structural adjustment and a general swing towards more outward-looking economic policies. Among other changes, the banking sector has been deregulated, preferential bank lending has been scaled back dramatically, local and foreign investment laws have been liberalised and streamlined, with foreign investment now being keenly courted, and the trade regime has been overhauled—with tariff and non-tariff barriers being lowered in a bid to encourage the growth of non-oil tradeable goods. In pursuing this orthodox neo-liberal recipe, Indonesia has won extensive praise from the World Bank. At one level, this reorientation away from broad interventionism and a reliance upon import-substitution strategies reflects the choices of individual politicians (Liddle 1991)—or, more generally, a realignment of the political matrix within the Indonesian bureaucracy, with the liberals within government regaining political ascendancy for the first time since the late 1960s. At a deeper level, however, it reflects fundamental changes in Indonesia's economic circumstances. If the oil boom drove Indonesia's economic growth in the 1970s, the dramatic collapse of oil prices in the 1980s took the wind out of the country's sails. Adding to its woes, other key commodity prices also fell, it was caught by unfavourable currency realignments and its exports suffered from the general slowdown in the global economy. In 1986 Indonesia suffered a severe economic slowdown and was confronting a balance of payments problem that was deteriorating at an alarming rate. Put simply, economic necessity demanded a change of policy and, in particular, moves to make the country more internationally competitive—especially in non-oil exports. With the active encouragement of institutions such as the World Bank,[3] the government's policy response has been to deregulate and facilitate private sector investment in export industries.

In addition to the deliberate retreat or drawing back of the state from extensive interventionism, the economic balance between the state and the private sector has also been tilted in favour of the latter by its faster long term rate of growth. Two decades of rapid economic development have seen the domestic private sector expand and surpass the state sector as the major engine of growth. The influx of foreign investment in the late 1980s further diminished the state sector's relative importance in the economy. Estimates by Hill (1994) of the relative importance of the state, the domestic private sector and foreign business as gauged by ownership are set out below. Although the state's share of economic activity is still large at 31 per cent, for present purposes the more important point is that this figure would assuredly have been significantly higher a decade ago.[4]

The strategic withdrawal of the state from the marketplace and the emergence of the private sector as the dominant force in the economy have been crucial trends. Less noticed, and still at an early stage, are moves by sections of private industry to organise themselves collectively for political action. As noted earlier, throughout most of the New Order period Indonesian industry has had remarkably little direct collective influence on policy. While certain individual business people

Table 9.1 Estimates of ownership shares in Indonesia, late 1980s (% of each sector's share of value added)

	Domestic	*Foreign*	*State*	*Sectoral Share of GDP (1988)*[a]
Mining				
oil & gas	0	50	50	15
other	30	30	40	1
Manufacturing				
oil & gas	0	0	100	4
other	59	17	24	14
Agriculture				
food crops, small-holders, livestock	100	0	0	18
fisheries, forestry, plantations	80	5	15	3
Construction	90	5	5	5
Utilities	0	0	100	1
Transport & communications	50	0	50	5
Trade & tourism	90	5	5	16
Banking & finance	30	5	65	4
State	0	0	100	8
Accommodation	90	0	10	3
Other services	100	0	0	4
TOTAL	57	12	31	
(excluding oil & gas)	71	5	25	

[a]Refers to share of GDP at current prices. These shares are used as weights to calculate the ownership in the last two rows.

Source: Hill 1990:55.

have been able to use personal ties with key government figures to great political advantage, most have been less fortunate. Although there have been few empirical studies in this area, there is evidence to suggest that factors which have in the past constrained the growth of collective action—an authoritarian corporatist political framework, ethnic tensions and ideological qualms about capitalism—are now less formidable obstacles than they were.

While the broad corporatist framework is still in place, activist groups in a number of industries are beginning to take control of their industry associations and to transform them into effective vehicles for collective action. In such cases industry bodies are being converted from formalistic institutions primarily serving the government's desire for extra-state political action into instruments for the advancement of business causes. From the limited empirical evidence available (Wibisono 1989; Robison 1988; MacIntyre 1991) the industries concerned seem to be ones dominated by the private sector. The associations tend to have structural features conducive to collective action, such as limited and concentrated memberships. The phenomenon is confined to industry- or sector-specific associations; the peak industry body, KADIN, remains very much a creature of the state. Examples of industry associations which have come to life can be seen in the textile, pharmaceutical, tyre, plywood, cigarette, venture capital and (recently) banking industries. While the impact of these organisations varies, the key point is that determined collective action is now emerging; interaction between industry and government—in some sectors at least—is no longer characterised by clientelism alone.

The relaxation, or perhaps circumvention, of corporatist controls at the industry level has been one factor facilitating the upsurge of collective action by business. Two other, somewhat intangible, factors also appear significant: shifting official and community attitudes towards business, and the blurring of ethnic and socio-economic divisions. Where once business—or, more broadly, capitalism—was viewed with public and official disdain, entrepreneurs are today the subject of media celebration. And while there can be no doubt that ethnic tensions between Chinese and indigenous Indonesians persist, the fact that large numbers of indigenous Indonesians have evidently found lucrative careers in the private sector means that the world of commerce and industry is no longer overwhelmingly the domain of Chinese Indonesians. Even though few indigenous Indonesians actually control large corporations, many now have a strong and immediate interest in the business world. By helping to destigmatise business and shake off its 'pariah' status these trends have also served to encourage open collective political action by industry groups.

But organised collective action is only in its infancy in Indonesia. Patrimonial linkages are still the norm. The amazing growth of the business empires of President Suharto's children in the last few years provides a salutary reminder of this. Nevertheless, in the longer run, the structural shift in the Indonesian economy associated with the relative expansion of the private sector points clearly to the likelihood of rationalisation of interactions between business and government. Pressure for this is likely to come from several sources. Most obviously, it will come from within the ranks of local firms which do not enjoy the special privileges of the fortunate few linked by patrimonial connections to power brokers in government. Whether it be individual entrepreneurs who have been forced to sell their businesses to predators with powerful connections, groups of firms profoundly antagonised by the rent-seeking practices of crony competitors in their (or related) industries, or a broad cross-section of the business community frustrated by the lack of a consistent regulatory and legal environment, there are clear material reasons for a majority of local firms to have an interest in limiting gross cronyism and producing a less uneven economic playing field.

While firms enjoying patrimonial privileges are likely to resist such pressures, not all will be greatly threatened by them. Among the big conglomerates that grew on the basis of patronage and continue to enjoy its benefits, some are considerably less dependent than others. Although clear evidence is limited, it seems likely that firms which are either large enough, or sufficiently prosperous and diversified, may well be able to survive a withdrawal of protection. The vast international corporate empire of Liem Sioe Liong, with turnover of around US$8 billion in 1990, is the most obvious example (Schwarz 1991: 46). But there are other leading firms that have built up empires which benefit from but do not wholly depend upon protection (Mackie 1992: 180; McKendrick 1992a: 104).

Pressure for change is also likely to come from foreign firms, especially those which are not in joint venture arrangements with local crony business people. The lack of regulatory consistency, the unenforceability of contracts and the uncertain proprietorial security of investments and specialised technologies are major concerns for foreign investors. With Indonesia having to compete with other cheap labour countries to attract foreign capital, footloose investors are in a position to command the attention of policy makers. More broadly, international development agencies are now beginning to weigh into the matter. The World Bank—long an advocate of deregulation in Indonesia—has recently stirred debate, arguing that legal reform must be given high priority if strong development is to be maintained (World Bank 1992c). As McKendrick (1992a: 106) succinctly puts it, 'the legal system has become a drag on both growth and fairness, and autonomous rules are now necessary'.

In sum, a range of actors have an interest in rationalising government regulation of business, limiting gross cronyism and promoting a more consistent and predictable legal framework. And pressure for a more level *commercial* playing field is likely to have the effect of promoting a less uneven *political* playing field for business, as it is clientelistic patterns of business–government intermediation that are so conducive to particularism and gross cronyism. These are long-term trends. In the absence of any sudden or unforeseen move to democratise in a serious fashion, change is likely to be concentrated in the corporatist structures in the business sector. It is reasonable to expect that, as has already happened in a number of cases, industry associations will increasingly be transformed from institutions dominated by the state to institutions which afford business a major and direct voice in the policy making process.

BUSINESS, GOVERNMENT AND INDUSTRIALISATION: REGIONAL COMPARISONS

The reorientation of Indonesian economic policy, and the influx of foreign capital since the revaluation of the major Northeast Asian currencies following the Plaza Accord, have underpinned Indonesia's return to rapid growth following the slump of the mid-1980s. Overall economic growth rates are strong (real average annual GDP growth of 7 per cent for 1988–92). Particularly noteworthy, also, is the dramatic surge in manufactured exports (real average annual growth of around 25 per cent for 1986–93). These growth rates have led to popular speculation that Indonesia may be following in the footsteps of such celebrated NICs as South Korea and Taiwan.

Although the income per capita levels of the Northeast Asian NICs remain very much higher,[5] Indonesia (along with Malaysia and Thailand) is indeed experiencing rapidly increasing living standards. Moreover, there are some striking similarities in terms of broad developmental strategies. Like Taiwan and South Korea thirty-odd years ago, Indonesia has recently begun to de-emphasise import substitution and to give strong priority to building up internationally competitive export industries, especially in labour-intensive manufactures. And, as in the Northeast Asian NICs, there is an underside to these economic achievements: because of the importance of low cost labour, the union movement has been subject to systematic exclusion and repression by the state (Hadiz 1992; Deyo 1988).

Important similarities such as these notwithstanding, the remarkable contrasts in business–government relations are more significant for our purposes here. In particular, we do not find in Indonesia the 'strong state' so widely credited with steering the Northeast Asian NICs through extremely rapid economic transformation; a state relatively insulated from rent-seekers and general societal pressures, and a state capable of intervening in the economy with coordinated trade and industrial policies that have succeeded (often enough) in producing the desired behaviour in firms (Amsden 1990; Deyo 1987; Haggard 1990; Onis 1991; Wade 1990; White 1988). Clearly Indonesia has had a decidedly authoritarian regime which has been every bit as repressive as that of Chiang Ching-kuo or Park Chung-Hee. As well, Indonesia's corporatist political architecture has succeeded in minimising collective action by the business community; for the most part, organised business has had surprisingly little voice in the formation of economic policy. However, while the state has been generally well insulated from *collective* action, it has certainly not been shielded from the myriad pressures of individual rent-seekers able to access policy-making processes with ease by virtue of clientelistic connections. Plainly, the impact of individual action of this sort on a wide scale can be every bit as debilitating as classic Olsonian distributional coalitions (Olson 1982).

Examples of individual business people manipulating or circumventing government regulations abound. In September 1991 the government announced a moratorium on a range of large scale investment projects, out of concern for the impact of the requisite foreign borrowings on the country's current account balance. This was seen as a decisive move by liberal economic ministers to rein in the swashbuckling activities of a number of leading conglomerates that threatened to damage the country's economic position through unrestrained foreign borrowings. Investors behind one such project—a US$1.8 billion petrochemical plant known as Chandra Asri—were determined to proceed regardless of the prohibition. Key players in the consortium were leading businessman Prajogo Pangestu and President Suharto's second son, Bambang Trihatmodjo. To the dismay of some (and the cynical resignation of others) the consortium relaunched the project as a wholly foreign-owned enterprise, thereby sidestepping the regulatory obstacles. Most observers viewed the ploy with scepticism, remaining convinced that Prajogo and Bambang would retain control of the operation, despite the appearance of 100 per cent foreign ownership.

A second illustration comes from the timber industry, Indonesia's second-largest export earner. It is widely recognised that the leading logging and timber-milling companies operate almost as laws unto themselves, routinely flouting government controls. One company, Barito Pacific (also owned by Prajogo Pangestu), was recently fined US$5.6 million for illegal logging, but simply refused to pay. Nothing was done to enforce the ruling. According to one seasoned observer the so-called king of the timber industry, Bob Hasan, 'is widely believed to have more say in Indonesia's forestry policies than the Minister of Forestry . . .' (Schwarz 1992: 44).

While the most vivid illustrations of the influence of cronyism usually involve people associated with President Suharto, there are countless parallels across all sectors of the economy involving business identities who enjoy links to senior figures in government. The important point here is that while the state may enjoy a high degree of insulation from organised group action by business people, it is very vulnerable to individualised pressure. Ministers, officials and even bank managers find it extremely difficult to resist requests for preferential treatment or the selective application of regulations (assuming they are inclined to resist) from individuals known to be closely associated with key government figures. On their own, many such requests are not of great economic significance; cumulatively, however, the impact is generally thought to be very considerable. Rent-seeking behaviour is of course not unknown in Taiwan or South Korea (see chapters 4 and 5); what sets Indonesia apart from the experiences of these Northeast Asian NICs is the scale of rent-seeking and the all too evident limits this imposes on the operational autonomy of economic ministries. If we add to this the fact that, as noted earlier, collective action by nascent industry organisations is now beginning to emerge and in some instances has played a part in facilitating the liberalisation moves of recent years (MacIntyre 1992), the Indonesian state emerges as decidedly less insulated from business interests by comparison with most accounts of the Northeast Asian NICs.

A related point of contrast between Indonesia and Taiwan or South Korea concerns the calibre or quality of the bureaucracy. Unlike its Northeast Asian counterparts, the Indonesian bureaucracy cannot be considered an elite service that succeeds in attracting highly trained and motivated graduates. With the exception of pockets of talent at senior echelons, there is a general shortage of well-educated officials. Salaries for Indonesian bureaucrats are very low and are, of necessity, supplemented by any 'alternative' income sources available. This presumably contributes directly to the endemic problem of corruption within the bureaucracy (World Bank 1993: 175–8). In short, in addition to the state being subject to myriad clientelistic pressures in the formulation of policy, policy implementation is constrained by the institutional weaknesses of the bureaucracy itself.

The degree of operational autonomy enjoyed by a state, together with its own organisational coherence and capabilities, bear directly upon its capacity to intervene effectively in the economy. Much scholarly attention has been given to the trade and industrial policies of the Northeast Asian NICs and the apparent capacity of the state in these countries to channel various forms of subsidies to priority industries in order to assist their development to the point at which they might begin to compete on international markets. Alice Amsden's widely cited 1990 study points to the capacity of the South Korean government to ensure that the subsidies it provided to developing industries were employed for productive purposes, and not simply frittered away as rents. The state was able to 'discipline' firms.

As indicated earlier, the Indonesian state has also intervened very extensively in the country's economic development. Setting aside thinly disguised efforts by state officials to allocate rents to personal associates in the name of nurturing local industry, there have been a number of senior government figures with a deep policy commitment to the idea of an activist state intervening to promote the development of local industrial capabilities (Robison 1986). While progress has been made in fostering this development in particular sectors such as aeronautics (McKendrick 1992b; Hill & Pang 1988) and automobiles (Chalmers 1988; Doner 1991), the costs involved have usually been very considerable and the level of success in realising government objectives a matter of debate.

The root of the problems of interventionist economic policies in Indonesia has been the inability of the government to ensure satisfactory policy implementation. Bureaucratic agencies have simply lacked the institutional capacity to oversee the usage of government subsidies to industry. Examples abound. For instance, in the case of preferential bank lending for which there were elaborate lists of priority categories, the Central Bank not only had little idea of the purposes to which cheap finance was actually put, but lacked even a clear picture of whether subsidised loans even reached the target groups (MacIntyre 1993). Other studies have also identified bureaucratic weaknesses as compromising the state's capacity for effective intervention (Biggs & Levy 1991; Bhattacharya & Linn 1988). A World Bank assessment comparing Indonesia's economic performance with that of South Korea and reviewing the quality of bank advice over the past decade summarises the issue:

> There was an undercurrent in [World] Bank Reports . . . that selective interventions on Korean lines could not work in countries like Indonesia because of weaker administrative and institutional structures, less clear economic objectives and skill limitations. There was merit to this argument: it accepted that selective interventions could make markets more efficient, but posed 'government failure' as a powerful offsetting risk . . . Korea represented a model of very detailed intervention, closely monitored and highly demanding of government capabilities. This may not be feasible for countries like Indonesia, given its administrative capabilities and political economy. (World Bank 1992b: 42)

Indonesia has recorded very encouraging economic progress over more than two decades, and in the last half-decade it has begun to compete successfully in global markets for manufactured goods. Notwithstanding some serious problems, Indonesia is prospering. And yet, plainly the pattern of relations between business and the state which underpins this prosperity differs significantly from the widely discussed model of the Northeast Asian NICs, featuring a strong developmental state. Relativities are important here, for if Indonesia does not possess a strong state at least it is not as bureaucratically incapacitated or mired in patrimonial politics as is Filipino-style 'booty capitalism' (see chapter 8). Thailand provides the closest comparison with Indonesia in the Asian region, for it too combines relatively weak state capabilities and pervasive patrimonialism with an impressive economic track record. However, even here there are important contrasts to be drawn.

Recent work on business–government relations in Thailand has pointed to the importance of cooperative and inclusionary corporatist linkages between state and industry in producing a negotiated consensus on key aspects of trade and industry policy. In his study of the automotive industry in Southeast Asia, Doner (1991: 234–5) argues that relations between state and business in Thailand have been characterised by 'functional concertation' which facilitated effective policy consultation and thus the development of local industrial capabilities. Anek (1992) identifies a comparable situation at the macro level; peak Thai industry associations being able to meet with the Prime Minister and other senior economic ministers on a regular and genuinely consultative basis to streamline industrial expansion through a liberal corporatist framework—the Joint Public and Private Sector Consultative Committee. As theories of collective action would suggest (Olson 1982; 1986), corporatist arrangements appear to have helped Thailand to cope with individual and group-based rent-seeking activities.

In Indonesia, corporatist arrangements in the business sector are for the most part still restrictive and exclusionary. There is nothing remotely comparable to Thailand's Joint Consultative Committee; KADIN (the Indonesian Chamber of Commerce and Industry) is routinely disregarded by the government in the development of economic policy. Although some industry-specific exceptions are emerging, the general pattern in Indonesia is for business associations to be excluded from the policy process. Relations between government and business may well evolve in a fashion broadly comparable to the Thai model over the next decade or so, but as yet the institutional arrangements for broad collective business input into the policy process along liberal or 'societal' corporatist lines (Schmitter 1974) are absent, and individualistic patrimonial forms of political action remain the norm.

This argument has important implications for the pace at which industrial development continues in Indonesia. Put simply, with limited state capacities and widespread rent-seeking activity—both individually through patrimonial networks and, increasingly, on the basis of collective action—there is a significant threat to continued high economic growth. An optimistic approach to this problem would highlight the undoubted success of economists within the government in sweeping aside various established rent-taking arrangements in their recent drive to liberalise the trade regime. Against this, however, sceptics would argue that the general swing towards more outward-looking and market-oriented policies, which has underpinned the recent rapid expansion of manufactured exports and the return to strong growth, was not simply a function of the policy preferences of liberal government economists but was stimulated by an alarming balance of payments problem and other factors. Without the continuing discipline imposed by a crisis of this sort, it is not clear what will sustain the process of economic adjustment in Indonesia in the medium-term future. While the nascent export industries are likely to provide growing coalitional support for the reform process, there is no a priori reason why such groups should outweigh opponents to reforms that abolish rent-taking opportunities and enforce the rigours of increased market competition. The fact that Indonesia lacks both a strong state and a developed system of corporatist arrangements for peak level consultation between government and business suggests the risk that economic policy will become increasingly ensnared by patrimonial or collective rent-seeking schemes is considerable.

NOTES

1 The best account of the importance of patrimonialism in modern Indonesian politics is Crouch (1979). For valuable comparative perspectives, see Hutchcroft's chapter in this volume (Chapter 8), Hutchcroft (1991) and McVey (1992).

2 Similar—though less dramatic—patterns pertained to entrepreneurs linked to other senior figures in the political elite. For instance, the larger-than-life former head of Pertamina (the giant state oil company), Ibnu Sutowo, was responsible for fostering the development of a range of smaller firms headed by young indigenous Indonesian entrepreneurs contracting in the oil industry (Aden 1992).

3 Interestingly, the World Bank apparently sees itself as having had an important hand in promoting policy reform. A recent World Bank study notes that 'The impressive growth of Indonesian industry was a testimony, among other things, to the Bank's sound analysis, advice and influence', and that Indonesia 'may also have been one of the Bank's greatest success stories overall in the 1980s' (World Bank 1992b: 43, 41).

4 No comparable estimates are available for the 1970s.

5 In 1990, GNP per capita in South Korea stood at US$5400 and in Indonesia US$570. The figures for Malaysia and Thailand were US$2320 and US$1420 respectively (World Bank 1992b: 218–19).

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10 Business, Politics and Policy in Northeast and Southeast Asia[1]

Stephan Haggard

The newly industrialising countries (NICs) of Asia—South Korea, Taiwan, Hong Kong and Singapore—have been the subject of debate on the roles that state and market play in economic development. Two issues are in question. The first concerns the extent to which state intervention has impeded or promoted growth in the region. Chapters 2 and 3 of this book constitute a succinct reconstruction of this controversy, which has centred largely on the question of the efficacy of industrial policies.

A related but distinct question concerns the social, institutional and political factors that have influenced economic performance. Though hypotheses have proliferated,[2] a major strand of theoretical and empirical work has argued that characteristics of the state, and of political institutions more broadly, have influenced the course of economic policy and development in the Asian NICs. The chapters of this book provide an opportunity to re-examine, refine and extend this approach—which I will call, interchangeably, 'statist' or 'institutionalist'[3]—through a comparison of the experiences of the Northeast Asian NICs (together with Singapore) and those of the newly-emerging economies of Southeast Asia. The focus on business–government relations allows us to assess hypotheses both about the role of state intervention and about the institutional bases of rapid growth.

In the first section, I reconstruct the theoretical logic underpinning the statist or institutionalist approach. In the second section, I advance a critique based on a re-conceptualisation of the relationship between political elites and the private sector. In the third and fourth sections, I outline some of the theoretically significant findings from the country studies, beginning with a reassessment of the literature on South Korea and Taiwan.

NORTHEAST ASIA AND THE STATIST MODEL REVISITED

With a few notable exceptions (North 1990), the political and institutional foundations of economic growth have long been the weak link in neoclassical analysis. If market-oriented policies have been optimal, why have so few governments pursued them? According to Islam (chapter 3 above), two developments in neoclassical political economy—the theories of rent-seeking and of the predatory state—promise to provide answers. Yet, despite his spirited defence, several theoretical biases prevent either from being of much practical use in understanding either business–government relations or the political economy of growth in the region.

Both the rent-seeking and predatory state models see any form of intervention as distortionary, the result of the dominance of either government or private interests over the public good; as a result, both are better at understanding why things go wrong than why they might go right. Yet as Matthews and Ravenhill (chapter 2) argue, the inevitability of government failure is overplayed in neoclassical accounts. It begs the question to begin with a theory that assumes that any departure from non-intervention (with the usual caveats about public goods, market imperfections etc.) marks a departure from efficiency. Rather, the analytic task is the opposite: given the ubiquity of government intervention, under what conditions is it more or less efficient and growth-promoting?

The rent-seeking and predatory state models are poorly equipped to answer this question as neither gives serious consideration to how government institutions structure politics, economic policy making and implementation.[4] The predatory state model conceptualises the government as a discriminating monopolist. The rent-seeking model sees the state as little more than a passive register of social demands. The explanation of Northeast Asia's success thus comes down either to noting that rent-seeking and predation were not extensive—without explaining why—or to showing that they were constrained by the pursuit of market-oriented policies—precisely the outcome to be explained in the first place! Though theoretically tractable, such models are simply too spare to capture important institutional variations in business–government relations that are of empirical interest.

In the political economy literature on Northeast Asia's rapid growth, by contrast, political institutions have played an important explanatory role (Haggard & Moon 1983; Gold 1986; Johnson 1987; Haggard & Cheng 1987; Chu 1989; Cheng 1990; Haggard 1988, 1990; Wade 1990, chs 7 and 8). Three lines of institutionalist argument can be distinguished, all of which rest on the way institutions affect the coherence, effectiveness and credibility of government policy.

The first line is that the NICs have enjoyed the advantages of competent, meritocratic bureaucracies; I will call this the 'state capacity' argument. The combination of high analytic capacity and strong socialisation to bureaucratic norms has produced good policy and the ability to correct policy mistakes quickly, while limiting bureaucratic rent-seeking. State capacity would presumably constitute an asset regardless of what economic policies the government pursued, but has been particularly important given the interventionist policy stance adopted by Korea, Taiwan and Singapore.

A second line of argument, which follows the work of John Zysman (Zysman 1983; Johnson, Tyson & Zysman 1989), is more closely identified with the critics of the neoclassical approach; I will call it the 'policy instrument' model. If we accept the strategic technology approach outlined by Matthews and Ravenhill, then a crucial precondition for effective policy is the possession of a repertoire of policy instruments that can be deployed to achieve industrial policy objectives and to control private sector behaviour. Zysman (1983), for example, focuses on the government's control of the financial system as a key determinant of the ability to conduct an effective industrial policy. But a variety of other instruments have also been associated with Northeast Asian industrial policy, from the organisation of cartels through control over entry and exit, to complicated tax rebate schemes for exporters, to the use of state-owned enterprises. These policy instruments cannot necessarily be developed on demand, however, because of various political and administrative constraints. Institutional legacies thus affect long-term economic performance by facilitating, permitting or eliminating certain policy options.

A third line of argument concerns the way representative institutions affect the conduct of economic policy; I will call this the 'political capacity' argument. The core of the argument is that growth-oriented policies are subject to collective action and coordination dilemmas. Social welfare is maximised by certain policy choices, but there are strong incentives for individuals or groups to seek policy outcomes that lead to sub-optimal performance.[5] Coherent economic policy thus requires restraints on the play of particularistic interests and the coordination of competing claims. Political institutions can amplify these collective action and coordination dilemmas or can mute them by structuring decision making, and politics more generally, in ways that maximise social welfare. Put differently, economic growth requires organisation, and political institutions may be more or less efficient in supplying it.[6]

This argument can be made more concrete by examining briefly the politics of several key economic policies. Despite the ongoing clash of interpretations, and important variations among the NICs themselves, four elements appear in virtually all accounts of the economic growth of South Korea and Taiwan:

1. Fiscal and monetary policies have contributed to relatively stable macroeconomic policy, which has facilitated savings and allowed the government to pursue a consistently export-oriented exchange rate policy.
2. Government policy has limited both the power and independence of unions; as a result, wage levels have been determined largely by conditions of supply and demand in the labour market.
3. Trade policy has provided protection for domestic producers while simultaneously allowing access to needed inputs at world market prices.
4. An activist industrial policy has deployed a variety of additional instruments, including fiscal and financial subsidies and even direct ownership of production, but has consistently placed particular attention on the promotion of exports and sustaining international competitiveness.

Institutions have had an effect on the politics of each of these policy areas. Coherent fiscal and monetary policies require not only technical sophistication, but the political capacity to impose taxes and to limit claims on government expenditures including those coming from the private sector. This capacity might result from institutional mechanisms that exclude or limit potential claimants from participation, as has been the case with the tightly controlled South Korean budgetary process; or through a process of delegation from politicians to technocrats, as in the case of Taiwan's powerful central bank. In either case a crucial sphere of economic policy making was depoliticised. As Jeffrey Sachs (1985) has argued most cogently, this difference is one of the most central ones separating the Northeast Asian NICs from other developing countries, particularly those in Latin America.

The position of labour has been a central point of controversy in the literature on the NICs (for a review, see Deyo 1989). In particular, there is debate over the extent to which labour repression has been a prerequisite of the export-led growth strategy. My own view is that wage determination in the NICs has been driven largely by market forces, with the exception of Singapore where government intervention has been somewhat more direct. During an initial period of labour abundance in the NICs, rapid absorption of labour was achieved with relatively slow real wage growth. As labour markets tightened, as they did in all of the NICs, real wages rose, signalling to the private sector the need to diversify away from labour-intensive manufacturing.

However, this market story is highly misleading, as it ignores other actions taken by governments that allowed wage determination to function as it did. To differing degrees across the NICs we find governments limiting workers' channels of redress; curtailing or banning strikes; limiting non-wage demands, such as those concerned with working conditions; and restricting the formation of linkages between unions and other political forces, from political parties to the Church. These controls clearly reflect a political environment in which the interests of management are favoured over those of workers, though the precise institutional mechanisms for doing this have varied across countries.

The politics of trade and industrial policy require somewhat more extended discussion, since they go to the heart of the business–government relationship that is the subject of this volume. The government's interest in actively promoting the development of the private sector—or at least some portions of it—implies an explicit or implicit alliance with business and assumes some minimal threshold of bureaucratic competence and analytic capacity.[7] But a pro-business government and a competent bureaucracy are not enough, because as the rent-seeking literature rightly emphasises, business can exploit an interventionist policy stance. Indeed, because of their power and organisation, we would expect that organised private sector groups would constitute the *greatest* threat to a coherent, export-oriented industrial policy. This is particularly true where governments have persisted over long periods of time in pursuing policies that favour import-substituting industries or the non-tradeable goods sector.

The key question is why government support has been made conditional on particular types of investment, particularly those that subject firms to the check of international competition. Why, to use Alice Amsden's word (1990: 14–18), has the state been able to 'discipline' the private sector?

For institutionalists the answer lies in part in the nature of the relationship between the public and private sectors. The state has both the capacity and the instruments to discipline business, and the business–government relationship has been structured to limit the opportunities for particularistic rent-seeking or for business control over the policy agenda. This has occurred in a number of ways, such as limits on the right of business to organise through independent industry associations or political parties and the delegation of substantial authority to the economic bureaucracy.

One mechanism of institutional control that appears in several accounts of Northeast Asian growth is the state-created industry association (Kim 1993). Though such channels grant business direct access to the government, they also provide the government with the organisational means for agenda setting and control. Wade, following the literature on European corporatism, outlines succinctly the logic of this 'state corporatist' view of business–government relations:

> [T]he state charters or creates a small number of interest groups, giving them a monopoly of representation of occupational interests in return for which it claims the right to monitor them in order to discourage the expression of narrow, conflictual demands . . . [and to] maximise compliance and cooperation. (Wade 1990: 27)

The institutionalist or statist approach can now be summarised. Growth hinges on effective government policy, usually taken to include some mix of stable macroeconomic policies and a growth-promoting industrial policy. Such effectiveness is dependent on bureaucratic capacity, on the existence and control of relevant policy instruments and on a certain degree of institutional insulation from social groups, including the private sector.[8] Though governments in the NICs have been broadly pro-business, political institutions have minimised capture by narrow private sector interests. Where they have existed, industry associations have not so much represented business interests to the government as communicate government concerns to the private sector.

THE STATIST MODEL: A CRITIQUE

Though I will argue that some important elements of this statist or institutionalist model are vindicated by the Southeast Asian experience, there is one criticism of the approach with which I am increasingly sympathetic. This is the criticism that the institutionalists address the *capacity* of the state but not its *motivations* (Haggard & Moon 1990; Moon 1990; Doner 1991b). As institutionalists reject the idea that government policy is the result of private sector pressures, why does a government choose to do what it does? In particular, why have the Northeast Asian governments chosen to embrace relatively efficient and outward-oriented policies rather than exploiting their power for predatory ends?

Institutionalists have answered this question in one of three ways. The first is ideology. State officials develop, inherit or import ideas about how to achieve economic growth and use their control over material and organisational resources to implement them.[9] In general, this approach is unsatisfying unless it explains where ideas and ideologies come from and why politicians have an incentive to select the ones that they do. However, several stories told about the NICs in this vein are plausible. Vogel argues that the highly successful Japanese model played an important role in economic thinking in the NICs (Vogel 1991). American advisers played a role in both South Korea and Taiwan, and there can be little doubt that Hong Kong's economic policy is difficult to understand without reference to the strong laissez-faire stance taken by a succession of British financial secretaries.

The second option is to argue that though state elites may be relatively independent from domestic social forces they are constrained by international pressures of various sorts. External economic agents—foreign firms and banks, international financial institutions, bilateral donors—have provided assistance to all of the NICs at some point, but they also acted as external agencies of restraint. Government officials may also be constrained by international economic shocks or by the openness of their economy to international competitive pressures. As domestic firms become increasingly internationalised, the cost to the government of pursuing policies that reduce national competitiveness becomes both higher and more readily apparent. Note, however, that this approach borders on a coalitional one in which the state is constrained by the interests of the more internationalised segments of capital (Gourevitch 1987).

Finally, the NICs' outward-looking industrial policies might be understood in terms of the material interests of the government itself. Though the rent-seeking and predatory state models assume that these interests will conflict with economic efficiency, there are a number of policy reforms that benefit the government directly. For example, one reason why the government pushed exports in South Korea and Taiwan was not because of an interest in efficiency or even growth, but because it provided government leaders with access to scarce foreign exchange. Similar arguments may be advanced with reference to fiscal and financial market reform.[10]

As a number of critics have pointed out (Doner 1991b; Doner & Hawes 1992; Haggard & Moon 1990; Moon, chapter 5 in this volume; MacIntyre 1991; Chiu 1992; Wade 1992; Evans 1992), these answers to the question of government motivation all paint a relatively passive picture of the private sector. Active and successful in markets, business is quiescent and limited in the political arena. This view also ignores the motives of state elites as *politicians*, namely to build coalitions of support and to maintain power.

Even if the government is not captured by the private sector, it is politically dependent on it in several important respects.[11] Unless willing and able to undertake productive activity directly, all governments rely on the private sector to produce the economic performance required to maintain power. Several governments in the region *have* relied heavily on state-owned enterprises, including Singapore, Taiwan, Malaysia and Indonesia; in all four cases the motivation was in part to gain or maintain independence from the private sector. Yet in no case did such a strategy fully obviate the need to guarantee private property rights or reach a *modus vivendi* with the private sector.

Governments also rely on business more directly for political, and particularly financial, support. It might be thought that this factor is more important in democratic settings where parties conduct competitive electoral campaigns. Yet it can also be important in authoritarian settings where elections are 'managed' and where political support is sustained through the dispensation of patronage.

Finally, the government depends on business for information; even effective monitoring and control are difficult without some degree of compliance by business in providing the government with information on its activities. Adequate flows of information should be particularly important for the interventionist industrial policies that have characterised Northeast Asia's growth.

These observations suggest that it may be useful to conceptualise the business–government relationship as an ongoing *negotiation* in which the government seeks political support, particular economic outcomes (aggregate, sectoral and local), and information. The private sector seeks a predictable and stable business environment and sector- and even firm-specific incentives.[12]

At least three dimensions of 'business–government relations' will influence the outcome of this bargaining relationship. First we need to know not only about the preferences of the private sector but also its political capacity: organisational coherence; ability to mobilise broader support from other segments of the population; ability to withdraw political and economic support.[13] The second factor of importance is political institutions, and the extent to which they provide opportunities for business access to, and control over, the policy agenda; this is the core of the institutionalist approach, and needs no further discussion. Finally, we need to know about the overall *political* relationship with the private sector: whether government and business are closely aligned (because politicians rely heavily on business support), operate at arm's length, or are actively antagonistic (as a result of ruling political alliances based on political forces hostile to capital). The country studies in this book show that variations in the policy choices across the Northeast and Southeast Asian countries frequently reflect broader political objectives of either supporting, controlling or even supplanting the private sector.

We are now in a position to review the evidence presented in this volume. Our central question is how business–government relations affect economic policy, industrial organisation and the sectoral allocation of investment and, through these intervening variables, economic performance. We interpret business–government relations not in terms of ideal types (such as the 'strong state'), but as an implicit or explicit political negotiation. This negotiation will be influenced by the interests and organisational capabilities of the private sector, the access private sector actors have to decision making, and the broader political relationship between the government and business elites.

Three findings emerge from the country studies. First, the coherence of government policy *does* depend on the nature of the political institutions structuring business–government relations. This is true not only in the Northeast Asian NICs, from which the 'statist' model was derived, but in the Southeast Asian cases as well. In this regard, institutionalist claims are partly vindicated, even though the Southeast Asian countries differ in a number of important respects from their NIC counterparts. A second finding, however, is that these institutional arrangements themselves are partly explained by the broader political relationship between the government and the private sector at critical historical junctures. At these critical junctures, institutional arrangements are forged that have persistent consequences for relations between the public and private sectors.

Finally, the studies show that the capacity of business to organise for political purposes has been increasing in all of the countries examined here. As business power increases, the institutional relations between the state and the private sector are once again undergoing changes that will have important implications for economic policy in the future.

BUSINESS–GOVERNMENT RELATIONS IN TAIWAN AND SOUTH KOREA

Both Yun-han Chu and Chung-in Moon emphasise the importance of institutional factors in understanding the coherence of the governments' economic development strategy in Taiwan and South

Korea. Both also emphasise that the heyday of the 'strong state' began to wane somewhat in the 1980s, as business power rose. Yet the studies (chapters 4 and 5 above) also bring out important differences between the two countries in policy, industrial structure, and the ownership patterns of investment that can be traced to the broader political relationship between business and government.

Taiwan probably represents the limiting case of the 'strong state' in our sample, and is a good example of the enduring effects of political institutions (see also Gold 1986, Winckler & Greenhalgh 1988). Chu indicates that the business community had little formal representation in the tightly organised ruling party and that technocrats were highly insulated from business interests. '[W]ithin the larger institutional framework', he writes, 'the business elite was on the fringe of the Kuomintang [KMT] power structure'. State power was buttressed by a relatively large state-owned enterprise sector, control over finance, and the state-corporatist organisation of business associations. Chu argues that these state-corporatist institutions substantially limited the private sector's access to decision making, though clientelistic relationships did develop between political leaders, technocrats and the largest firms (see also Gold 1986).

Business–government relations were not simply a result of the organisational power of the KMT party-state, however; they were also driven by the political divide that existed between the mainlander government and the local Taiwanese economic elite (Winckler 1988). In general, this divide favoured the government's freedom of manoeuvre: 'the state was relatively unconstrained by personal or family loyalties between officials and business people . . .' Nor, given the authoritarian nature of the regime and its strong party structure, did the government depend heavily on the business community for political support.

Industrial structure figures as both a cause and a consequence of this arm's-length political relationship. On the one hand, the historical legacy of a relatively decentralised industrial structure, with a large number of small family firms, hindered close business–government ties except for a handful of the larger groups. On the other hand, the government self-consciously sought to check the growth and concentration of large Taiwanese capital for political reasons (Gold 1986; Hamilton & Biggart 1988). As Cheng (1990) argues, this was one reason why industrial policy does not show the same degree of sector- and firm-specific activism visible in South Korea (despite the fact that the government controlled a wide array of policy instruments), and why the government showed a strong propensity to use state-owned enterprises to achieve industrial policy goals.

Chu notes that the regime was interested in securing the loyalty of business, and did so through a variety of targeted policies. In my view, however, international factors carry more weight in explaining the economic policy reform of the 1950s and 1960s than do pressures from the private sector (Simon 1988). The United States was sceptical of the large state-owned enterprise sector and used aid to foster the development of private capital for both political and economic reasons. In alliance with 'developmentalists' within the technocracy, and in the face of balance of payments difficulties, US aid supported a number of sector-specific policies aimed at developing import-substituting industries in the 1950s and at promoting exports in the 1960s.

Though it is South Korea rather than Taiwan that is typically considered the archetypal 'strong state' NIC, this confuses the policy and political meaning of the concept. South Korea was more interventionist, but this intervention sprang partly from the government's greater political vulnerability and dependence on business support.

This was certainly the case in the 1950s, when the close political relationship between Rhee, the Liberal Party and the private sector gave rise to extensive rent-seeking (Haggard, Kim and Moon 1991). The reform period of the early 1960s is somewhat more controversial, however, and the role of business in the process still awaits full monographic treatment. However, it is clear that the political position of the private sector was substantially weakened by the student revolution of 1960 and the military takeover of 1961. The military had exploited popular discontent with corruption, and younger colonels had even called for the execution of prominent business leaders. The military exploited this change in the political position of business to initiate institutional changes that substantially reduced the opportunities for rent-seeking. The legislature was closed, parties banned and the institutions of economic policy making substantially reformed to enhance their insulation from rent-seeking pressures. Sectoral business organisations were formed under government guidance and used to monitor business behaviour. The seizure of the financial system also provided the government with a crucial instrument for enforcing its policy preferences.

Yet the military leadership was ultimately much more dependent on private sector support than was the case in Taiwan. The state-owned enterprise sector was relatively small and the military lacked a party apparatus that could provide an organised base of political support. Unlike the KMT, the South Korean military came under strong pressure to make a transition to (nominally) democratic rule, which increased the demand for sources of political funds that could only be supplied by business. In contrast to Taiwan, South Korea witnessed the development of a relatively independent big-business organisation, the Federation of Korean Industries (FKI).[14] Even before 1964, the military had begun to reach a *modus vivendi* with the firms represented by FKI, particularly through the provision of preferential finance.

As in Taiwan, industrial organisation was both a cause and a consequence of these policy outcomes. In the 1950s, Korean business already appeared more concentrated than in Taiwan, providing the private sector with greater political leverage (Fields 1990; Hamilton and Biggart 1988; Hamilton 1991). Yet the government's political strategy of forging close relations with the private sector also led Park to encourage the concentration of favoured private-sector partners, particularly as the political coalition supporting the regime narrowed. The most spectacular growth of the *chaebol* occurred precisely during the period of the authoritarian Yushin constitution (1973–80) (Fields 1990; Kim forthcoming).

In sum, the early period of export-led growth in both countries vindicates a number of the expectations of the institutionalist model. Strong state institutions did expand the freedom of manoeuvre of government elites and contribute to the coherence of government reform efforts. However, political characteristics of the business–government relationship also help account for important policy differences. In Taiwan, the arm's-length relationship with business and the interest in limiting the concentration of private sector power served to circumscribe government support for the private sector and to channel government actions into activities over which it had immediate control, such as state-owned enterprises. In South Korea, by contrast, the government's greater political dependence on the private sector encouraged closer institutional linkages between state and business; more explicit political exchanges (in the form of various 'political funds'); more direct government support of industry, particularly through the financial sector; and a more concentrated industrial structure.

Both Yun-han Chu and Chung-in Moon emphasise the growing political power of business in the 1980s. In Taiwan, protectionist constraints on the labour-intensive, export-led growth strategy and increasing pressure to open the domestic market forced a change in industrial strategy. To maintain the forward momentum in complex high-tech industries the government forged closer relations with the private sector, both granting greater representation in the policy-making process and extending more differentiated forms of assistance.

Yet Chu stresses that more purely political factors were also at work. First, the very success of economic development increased the relative size of the private sector as a whole vis-a-vis the state-owned enterprise sector. Large private groups also emerged. The organisational capabilities of the private sector increased accordingly. Even more important, however, was the increased dependence of the KMT on business backing. As electoral politics became a more important component of the KMT's strategy of rule, the quest for sources of political funding became more intense, the barriers separating the party from the private sector blurred, and the autonomy of the technocrats vis-a-vis business interests declined.

Though the changed political context has given rise to new opportunities for rent-seeking and corruption, Chu argues that the dominant effect on economic policy has been liberalising. Business sought to free itself from burdensome regulations and particularly from restraints on the range of its investment activities. Chu concludes by noting that the interests of the party and of the private sector converge on a number of important points: 'Both see the need for the involvement of an active state in the process of industrial upgrading, both put economic growth before environmental considerations, both favour a slow growth in social welfare spending, and both support a state-orchestrated exclusion of organised labour from economic policy-making'. These shared interests constitute the basis for what Chu calls a new conservative coalition.

Chung-in Moon's account of the neo-liberal reforms of the 1980s shows certain similarities to the period of military-led reform in the early 1960s; again, both the weakened political position of business and the institutional power of government play a role in understanding the reforms (Moon 1988; Haggard & Moon 1990). Attempting to draw on growing public and political opposition to the close and corrupt business–government relations that had emerged during the late Park period, the new military government of Chun Doo Hwan sought to stabilise the economy and reverse the highly interventionist policy course associated with the heavy industry drive. Though some of the liberalising reforms ultimately profited big business, many were explicitly aimed at reducing the influence of, and benefits flowing to, the largest *chaebol*. These included anti-monopoly and fair trade laws, trade, reduction in preferential credit in favour of small and medium-sized firms, and the efforts to restructure a number of particular industrial sectors. Economic policy became a tool in an unsuccessful effort to construct a new growth coalition.

Despite these efforts, Moon notes a fundamental difference from the earlier period: the substantial increase in the organisational capabilities of big business. The main source of this change was the spectacular concentration of the industrial structure. This process began in the 1970s when the Park government initiated a heavy and chemical industry plan, supported by a close clientelistic relationship between the executive and the largest firms. Though apparently the initiative of a 'strong' state, the concentration of the *chaebol* that resulted from the heavy industry push gave them blackmail power over a number of government initiatives (Haggard & Moon 1990).

As in Taiwan, changes in political institutions also influenced the nature of business influence over politics. The transition to democracy initially gave Roh Tae Woo strong incentives to continue to distance himself from big business; throughout his term in office he periodically took initiatives to curb business power. But with the stalemate in both the legislature and in the streets, the government moved in a conservative, pro-business direction in 1990. Moreover, the open political environment also provided new opportunities for business groups to air their grievances and to back new political options, including Chung Ju Yung's bid for the presidency.

Thus we see both commonalities and differences between South Korea and Taiwan in the 1980s. On the one hand, the growth of the largest firms and of business associations provided new opportunities for business to air its grievances about government policy, lobbying for continued support in some areas and deregulation in others. Yet differences in the political landscape also played an important role in the course of government policy. In Taiwan, the ruling KMT continues to enjoy a majority and has forged a conservative coalition with business around broad continuity in policy and new opportunities for business representation in both party and state policy-making machinery. In South Korea, by contrast, Roh's conservative coalition faced a more vociferous left and the government itself faced much more concentrated business power. As a result, Roh's generally pro-business stance alternated with efforts to reduce the overweening influence of the *chaebol*.

THE SOUTHEAST ASIAN CASES

In his introduction, MacIntyre argues that the Southeast Asian countries (with the exception of the Philippines) are moving along an export-oriented growth path, but doing so on the basis of quite different policy and political frameworks. He argues, first, that the interventionist industrial policies have played a less substantial role in the transition to export-led growth than they have in the Northeast Asian NICs; second, that the bureaucracies are less competent; and finally, that the governments are less insulated from political pressures.

I find this overall characterisation plausible, but in contrast to

MacIntyre I emphasise some commonalities that cut across the Northeast and Southeast Asian cases, as well as differences among Thailand, Indonesia, Malaysia and the Philippines.[15] First, I argue that institutional insulation does play an important role in at least one component of economic policy in Thailand, Indonesia, Malaysia and even the Philippines; namely, the maintenance of relatively stable macroeconomic policies. This constitutes a sharp contrast with a number of other middle-income countries, particularly those in Latin America (Sachs 1985).

Second, the differences in the industrial policy regimes in the four ASEAN countries can be explained by the nature of the political relationship between state and business. In Thailand, government has been favourably disposed toward the private sector, but until the 1980s business organisation was relatively weak and lacked institutionalised access to the government outside particular patron–client relations. In general, the government maintained tight control over the policy process. Despite substantial corruption in some areas, and the emergence of business–government cooperation on Northeast Asian lines in other sectors (Doner 1991a), the result was a relatively non-interventionist industrial policy stance. This stance, in turn, had the effect of encouraging both foreign investors and local firms to exploit the country's comparative advantage in export-oriented manufacturing.

In Malaysia and Indonesia, ethnic politics are critical and a distinction must be made as to the government's relationship with the Chinese and the 'indigenous' (in Malaysia, *bumiputra*; in Indonesia, *pribumi*) segments of the private sector. At one level, the relationship between the government and Chinese business is conflictual because of recurrent political efforts to control the latter's activities in order to advance 'indigenous' business interests. This has been particularly true in Malaysia, where the party system generated both electoral and interest group pressure on the government to support Malay entrepreneurs. In Indonesia the goal of advancing the *pribumi* has been a recurrent political theme, but political channels did not exist for the private sector to articulate its demands. As a result, business representation moved through informal, personalistic networks to a greater degree.

At the same time, however, the apparent conflict between Chinese capital and the state has been mitigated by the development of close personalistic relationships between top political elites, bureaucrats and the larger Chinese enterprises, particularly in Indonesia. These relationships have been based on an exchange of political support, including political funds, for protection and economic advantages.

Because of these political and institutional characteristics of the public–private sector relationship in the two countries, rent-seeking and predatory state models are more applicable. Subsidies and protection for 'indigenous' segments of the private sector in the import-substituting and non-traded goods sectors have been coupled with corrupt ties with Chinese business. In both countries, governments have also sought to compensate for the weakness of the 'indigenous' private sector with the creation of state-owned enterprises, which in turn have become an important locus of power, patronage and rent-seeking.

Finally, in the Philippines, business–government relations have been exceedingly close; but under conditions of an economically powerful and diversified oligarchy, rulers who draw little distinction between the public and private spheres, and weak institutions for structuring the business–government nexus in an efficient and growth-promoting way. The result has been an ineffective industrial policy, dominated by cronyism.

Thailand

The comparative puzzle presented by Thailand is its long history of relatively stable macroeconomic policy coupled with a relatively non-interventionist policy style at the industry level. From the late 19th century until the 1930s a combination of good agricultural performance, strong domestic participation in agricultural trade and fear of foreign political penetration all served to limit government intervention in markets (Doner and Unger 1993). Pressure from the domestic private sector was also minimal. The combination of business links to a highly competitive agricultural export sector, the relatively small size of manufacturing compared to commerce and the highly institutionalised nature of the traditional Thai polity all served to block the emergence of a rent-seeking, import-substituting coalition.

Thailand did experience a period of greater state involvement in the economy beginning in the early 1950s when the military created a number of new state-owned enterprises and sought to curb the power of Chinese entrepreneurs. Under Sarit and his successors (1957–73) the government made a transition in strategy: portions of the military reacted against the costs of the interventionist strategy and granted substantially more independence to business, including its dominant Sino-Thai segment. Not only did traditional commerce and bank-based groups thrive, but a new generation of Thai capital emerged in the manufacturing sector. These firms gained from several mild industrial incentives and new opportunities to forge ties with foreign capital. The reforms of Sarit and his successors did not eliminate clientelism and corruption, but their negative consequences were bounded by important institutional changes in the system of economic management. These included centralisation of budgetary policy and expanding the technical competence of the economic bureaucracy. The independence of the central bank was also maintained.

As in the Northeast Asian NICs, the power of business in Thailand continued to increase over the 1970s. The reasons lay in the rapid growth of the economy and corresponding growth of large business groups, increased organisational efforts by the private sector itself and the gradual liberalisation of politics. Business organisations had become more coherent during the authoritarian interlude of 1976–79, and responded in 1978 to the government's call for a consultative committee to review economic policy. The relationship with the major business associations was further consolidated in 1981 through the creation of a Joint Public and Private Sector Consultative Committee (JPPCC), which linked the prime minister and economic bureaucracy directly with representatives of the largest business associations. Anek's (1992) study of the rise of business influence emphasises that the JPPCC served as a channel for business demands on government. Yet he also notes that the JPPCC provided a base of support for the government for both political and economic reform, including the difficult adjustment measures undertaken during the 1981–84 period.

It is important to underline, however, that business operated in a political and institutional context that still granted the government substantial power over the overall economic policy agenda. Prem maintained the prerogative to promote or transfer senior civil servants as he wished without legislative approval and to appoint non-elected officials to his Cabinet, shielding economic decision making from direct party and business influences to a substantial degree. The National Economic and Social Development Board, an important agency in developing the policy agenda and monitoring implementation, was entirely technocratic in make-up. Party-based cabinet officials were represented on a second important decision-making body, the Council of Economic Ministers, but they were outnumbered by bureaucrats and advisers and by non-party politicians appointed by Prem.

Business access to decision making varied by functional area. With reference to the formulation and implementation of macroeconomic policy, the executive and bureaucracy were extremely powerful. Party politicians in the Cabinet had the right to review budgets prepared in the bureaucracy, but the proposals submitted by the Budget Bureau were rarely changed significantly and the Senate and the House were not permitted to initiate spending bills or increase expenditures.[16] In effect, politicians were limited to seeking pork-barrel projects for their districts within parameters strictly controlled by the bureaucracy. This ability to control fiscal and monetary policy and to undertake needed exchange rate adjustments—as Thailand did in the early 1980s—is a central precondition for the pursuit of an effective export-oriented growth strategy.

With reference to trade and industrial policy, Doner and Anek (forthcoming) and Christensen (1992) argue that business had more success in penetrating the government: trade liberalisation measures were blocked in the 1980s and subsidies to exporters increased. Yet, as we know from South Korea and Taiwan, such policies are not necessarily a block to successful growth, and may contribute to it if they are not excessive and seek to assist the transition of competitive firms into world markets. Though further research is needed on the issue, this appears to be what occurred.

The parliamentary elections of 1988 marked yet another step toward genuine parliamentary rule; as we might expect, this institutional change had an influence on the pattern of economic policy making. Chatichai, the first elected leader to head a government since 1976, quickly appointed politicians or wealthy party backers to virtually all cabinet posts and intervened in the bureaucracy in various ways. The government also relied much less on business support through the JPPCC system. Particular business demands were now channelled to an increasing extent through the parties, in part precisely to circumvent the technocratic influence that had characterised the JPPCC system under Prem.

The limits on the ability of political parties to raise funds coupled with the traditional practice of vote-buying gave rise to closer relations between politicians and private sector supporters. Party bosses also cultivated relations with local officials who provided an important base of support and linkage with constituencies, particularly in the rural areas. To solidify, and pay for, these bases of support, politicians naturally became more aggressive in seeking government favours. In short, economic policy was characterised to a greater extent by rent-seeking.

As the 1991 coup demonstrated, however, these developments were reversible. Exploiting disaffection with parliamentary rule—including disaffection among the Bangkok business class—the military swept back into power. It is a further vindication of the institutionalist approach that the new government, based on an alliance between the military, technocracy and progressive segments of the private sector, quickly undertook some of the most wide-ranging economic reforms in recent Thai history.

It is true, as MacIntyre argues, that the Thai bureaucracy lacked the analytic capacity or the highly differentiated policy instruments of the Northeast Asian NICs. However, institutional arrangements did facilitate the government's ability to undertake quite substantial reforms; this was true both of the first half of the 1980s and again following the 1991 coup. Moreover, except for the period of rent-seeking under Chatichai, a combination of structural economic factors (the openness of the economy, the importance of rice exports) and political and bureaucratic institutions did serve as a check on business rent-seeking. In sum, the contrast with the Northeast Asian NICs should not be overdrawn.

Malaysia

The situation in Malaysia—and in Indonesia—presents some revealing contrasts to that in Thailand as they, too, had to respond to the 'problem' of an economically powerful Chinese minority. While the Thai government had accommodated these interests by the 1960s, political elites in Malaysia and Indonesia moved in the opposite direction, constructing ruling formulae that, at least formally, exhibited a greater hostility to the Chinese. This political fact coloured all aspects of economic policy.

The key relationships for understanding economic policy in Malaysia are those between the Malay-dominated ruling party (UMNO) and the allied Malayan Civil Service—which together have exercised monopoly control over the government since independence—and the Chinese business community (Jesudason 1989; Bowie 1991; Koon 1992). Formally, inter-ethnic relations have been mediated by a grand coalition dominated by UMNO but through which the conservative Chinese business community enjoys representation via the Malaysian Chinese Association (MCA). Yet, within that overall settlement or pact, the balance of power has undergone some important shifts that have influenced industrial policy.

Before turning to that issue, however, it is worth digressing briefly on a topic that Bowie does not address in chapter 6: the institutions governing macroeconomic policy. As in Thailand, this policy area has remained relatively depoliticised and thus also provides some important confirmation for institutionalist arguments. The industrial policies designed to assist the Malays contributed to large fiscal deficits in the early 1970s, but high domestic savings rates and lucrative trade taxes made it possible to finance them in a non-inflationary way. These purely economic features of the Malaysian economy, and its openness, have clearly contributed to low inflation and consistent exchange rate policies. Yet the political insulation and conservative orientation of the

Malaysian monetary authorities, a legacy of the British currency board system, also contributed to the outcome. Moreover, the country's high savings rate is partly attributable to fiscal policy, including particularly the government's ability to extract forced savings through high social security contributions. As we will see, this pool of savings was used to political ends, but the capacity to impose taxes and to control monetary policy contributed to macroeconomic stability.

With reference to industrial policy, the government has been caught between two conflicting imperatives: the political interest in fostering and responding to the interests of its Malay political base, and the need to placate and promote the Chinese private sector and foreign investors in the name of economic growth. The political institutions inherited from the British play a key role in understanding the resolution of this dilemma. Malaysia's democratic political structure, electoral pressures and the existence of a strong party apparatus have created both incentives and opportunities for rent-seeking. Moreover, and in contrast to Indonesia, they have provided the political space for the emergence of a mild form of what might be called 'populist nationalism'. These political factors have served the interests of a new Malay business class.

Prior to the riots of 1969, the bureaucracy had a strong, even dominant, role in formulating policy and pursued a restrained course under which Chinese capital flourished. Government policy was focused primarily on agriculture. Industrial policy was arm's-length and consisted of non-targeted incentives and the provision of public goods such as infrastructure. Protection was relatively low (Lim 1992). But a poor electoral showing by the UMNO in May 1969 and ensuing ethnic riots pushed Malay political leaders to 'rescind their earlier implicit commitment not to use the power of the state apparatus to wring concessions from non-Malay business'. A range of government interventions ensued, designed to favour both Malay business and employment.

The government faced a profound dilemma in pursuing this strategy: the growing political importance of extending support to the Malay private sector was not matched by equal economic capabilities. The government response consisted of two components: one of which increased both growth and efficiency, the other of which was almost certainly a drag on them. First, the government aggressively encouraged direct foreign investment in offshore processing industries, a strategy which allowed Malaysia to capture more than its share of expanding Japanese investment in the late 1980s (Jesudason 1989: 6). The success of these industries was no doubt responsible for the belief that Malaysia was following the path of the Northeast Asian NICs.

The other response was to foster greater state involvement in the economy, including that undertaken via state-owned enterprises and other government bodies, and even party bodies. On the surface, this dualistic strategy of courting export-oriented foreign investment while also pursuing state-led industrial development bears a superficial similarity to the Northeast Asian model. The difference lay precisely in politics.

The problem was not, as MacIntyre suggests, that Malaysia lacked a competent policy bureaucracy; on the contrary, Malaysia inherited a highly competent cadre of British-trained higher civil servants. These civil servants were partly responsible for the early industrial policy initiatives of the 1970s (Leigh 1992: 118). The problem was that the broader political structure increasingly limited the capacity of the bureaucracy to define a coherent policy course. Instruments such as protection, the provision of finance, licensing, quotas and government contracts were used to redress the economic imbalance between Malays and Chinese, though a number of studies have noted that the Chinese held their own by forming strategic political partnerships with *bumiputra* counterparts (Ling 1992; Koon 1992). The government's strategy was not limited to promoting the Malay private sector; a substantial state-owned enterprise sector also emerged. Initially, this was designed as a kind of trusteeship, which would ultimately be privatised to Malay businesses; it quickly grew into a sprawling political empire controlled ultimately by the ruling party, but with its own independent base of support not only in its management and workers but in linked Malay businesses.

Much attention has been given both to Mahathir's 'Look East' policy of industrial deepening and the political implications of his ascent to the Prime Ministership. Bowie's analysis suggests that both were not so much a departure from the New Economic Policy of the 1970s as its culmination. The new strategy was based on the same assumption of the political necessity of checking the relative power of Chinese capital while substituting for the weakness of Malay business through greater reliance on the mechanism of the state-owned enterprise. The economic results included erratic growth and mounting inefficiencies and losses in particular projects.

The political effects, however, were a further step forward in the creation of what Yoshihara (1988: 74) calls a 'bureaucratic' Malay business class (see also Ling 1992). Perhaps one of the most interesting developments—and one which reveals the importance of party politics—was the creation of a corporate vehicle by the UMNO itself and the accumulation of substantial party assets through exploitation of quotas on ownership. Bowie's analysis of party involvement in economic activity shows not only the erosion of lines between government, party and private sector, but also the increasing tendency toward authoritarianism required to maintain the party's political monopoly intact.

Not until the late 1980s—in the face of rapidly deteriorating economic performance—did the government begin to reconsider its policy course and move in the direction of liberalisation. The timing was auspicious: despite the domestic shake-out among a number of politically connected groups, Japanese direct foreign investment boomed.

Bowie suggests that domestic liberalisation is likely to be ersatz because of the dependence of the emergent Malay business elite (and, increasingly, their Chinese partners) on government largesse (Ling 1992). Bowie characterises the system as one of 'reciprocity whereby business grants a "piece of the action" in return for state support and protection from unexpected regulatory outcomes', and suggests that the nature of the government's relationship with Malay business may actually *preclude* the formation of an internationally competitive manufacturing sector. This outcome is altogether possible, though it should be remembered that extensive government support for domestic entrepreneurs was also a feature of South Korean and Taiwanese development in the early postwar period. It is at least possible that the relatively open trade and investment policy the country has pursued will encourage the emergence of a new export-oriented manufacturing class.

The Philippines

The poor economic performance of the Philippines constitutes a major issue in the comparative analysis of the ASEAN economies. In the 1950s, the country held greater economic promise than any in the region, including the NICs. By the 1980s, Philippine economic performance had been surpassed not only by Korea and Taiwan but by Indonesia, Malaysia and Thailand, and the government was forced to wrestle with the most wrenching adjustment crisis in the region.

A number of critics on the left have adopted a position akin to that of traditional Philippine nationalism, arguing that the country's problems stem from the adoption of outward-oriented policies at the behest of the World Bank and the IMF.[17] For the most part, however, there is a surprising consensus that the problem is virtually the opposite: domestic (structures rather than international pressures), and, particularly, a combination of deeply entrenched class structure and weak political institutions have *prevented* the government from adopting export-oriented policies.

On each dimension of 'state strength', the Philippine government is decidedly weak. As Hutchcroft argues in chapter 8 above, the problem is not simply that the Philippine public administration has been poor or that the government lacks policy instruments for supporting business, though both are true; the state is even incapable of providing the basic legal and administrative underpinnings necessary for a market economy to function. The more profound problem is the low 'political capacity' of the state: 'faced with the myriad particularistic demands of powerful elite interests, the Philippine state is unable to formulate or implement a coherent policy of economic development'.

Hutchcroft defines the Philippine system as 'booty capitalism' on the basis of the relative weakness of the government vis-a-vis the private sector and the patrimonial nature of business–government relations. Hutchcroft's typology suggests one of the key distinguishing features between Indonesia and the Philippines. Though Indonesian industrial policy is characterised by extensive clientelistic ties, they operate in a political and institutional setting in which government officials are capable of dictating the terms of the relationship. In the Philippines, by contrast, this is not the case. Dominant social forces are extremely powerful. In contrast to the situation in all of the other countries in our sample, the Philippine social elite is landed, providing it with an economic base separated from the state. Business organisation, though weak at the association level, has been facilitated by the highly concentrated nature of family groups which have diversified away from agriculture into both manufacturing and services on the basis of extensive state protection. The concentration of big business enhances its clout vis-a-vis both politicians and officials.

Though I generally concur with the thrust of Hutchcroft's analysis, I would place somewhat more emphasis on changes in the political relationship between government and the private sector over time and in the institutions structuring their relationship. The democratic institutions transplanted from the United States during the colonial period provided ample opportunity for the rent-seeking Hutchcroft describes. In the late 1960s, the Marcos government attempted to develop a more centralised industrial policy capacity, particularly around the Board of Investments (Doner 1991a), but it was quickly captured by powerful oligarchic groups diversifying into import-substituting activities.

With the declaration of martial law, the relationship with the traditional oligarchy shifted. No longer beholden to traditional politicians or social elites, and no longer constrained by electoral politics, Marcos could use the instruments of office to build a new base of support among his cronies. Elsewhere, I have described the new policy system as 'dualistic' (Haggard 1989). On the one hand, Marcos drew on a handful of highly competent technocrats to assist in his quest for foreign support. But the real centre of decision-making power resided with the Marcoses. The government's relations with business—always personalistic—became even more so as the first family became directly involved in a range of particular projects. Government agencies, such as the Ministry of Human Settlements, became little more than instruments for the dispensation of patronage.

With the transition to democracy, the relationship with the private sector shifted once again. The cronies, many of whom had been wiped out by the financial crises of the early- to mid-1980s, saw a sharp reduction of their access to government. Other portions of the private sector, particularly the non-crony private sector opposition to Marcos, gained influence. This segment of business had a 'modernising' wing, exemplified by Jaime Ongpin, who took economic portfolios in the new government and initiated important economic reforms during the early years of the Aquino administration.

But this period of relative state autonomy and an alliance with a modernising faction of the private sector did not last. With the reconvening of Congress, the oligarchy once again gained channels of access to government, both directly through the legislature and indirectly through their support for political candidates. Though democratisation arguably provided some checks on corruption, the absence of strong political alternatives to personalistic politics weakened the hand of the government in its efforts to reform relations with the private sector.

Indonesia

Despite numerous other differences—including the level of overall economic development and the structure of output—Indonesia has certain similarities with Malaysia in the political dynamics of business–government relations. Political elites and corresponding political structures have shifted over time in important ways, but have consistently rested on coalitions that are suspicious of the power of Chinese Indonesian capital. As in Malaysia, the ruling coalition's central dilemma was the relative economic weakness of the 'indigenous' Indonesian private sector alternative (Robison 1986; MacIntyre 1991). As a result—and again as in Malaysia—the effort to foster indigenous business has been one motivating factor in patterns of Indonesian government intervention.

The institutional locus of these efforts differed from those in Malaysia in several respects, with important consequences for policy.

The authoritarian nature of the regime, the structure of political institutions linking government and business, and the organisational and economic weakness of the Indonesian private sector all served to increase the relative power of state actors. The dominant political party (Golkar) did not play a role in mediating business interests; rather, business representation was channelled through state-corporatist organisations and more importantly through informal, personalistic channels. The effect of this structure was an industrial policy—if it can be called that—that favoured state elites directly (managers of state-owned enterprises, the military and the president's family) and, ironically, the very large Chinese firms that the government's policy was nominally designed to contain.

Business–government relations and the institutional structure for managing them evolved through several stages. Initially, the post-independence democratic system created a triangular set of linkages between party politicians, bureaucrats and segments of local capital, both indigenous and Chinese (Robison 1986). During the late Sukarno period, the increasing concentration of power in the executive shifted the locus of rent-seeking and patronage away from the parties toward senior civil servants and the military, a pattern that was to persist and deepen following the economic and political crisis and change of regime in 1966. During this so-called Guided Economy phase the strategy of the government also shifted in a decidedly more statist direction. Dutch assets were nationalised and the state-owned enterprise sector grew apace.

Yet the Guided Economy strategy was ultimately unsustainable. The reasons are revealing, since they mark a sharp contrast with Malaysia and show clearly the central importance of institutions for shielding macroeconomic policy from the pull of distributive conflicts. By the early 1960s the reduced influence of the technocrats, and efforts by Sukarno to placate the demands of increasingly polarised political groups, resulted in massive fiscal deficits, financed largely by money creation. The Planning Council degenerated into a purely political entity, and the increasing entry of the army into the government resulted in ongoing interference in policy making. Technocrats attempted a stabilisation program in 1963, but the bureaucracy, army, Communists and Sukarno's policy of military *konfrontasi* with Malaysia all combined to derail the program. In 1965, the country slipped into hyperinflation.

Stabilisation came only after a military coup resulting in Suharto's assumption of power. In 1966, Suharto's ear was captured by a group of western-trained economists who assisted in the design of a stabilisation plan that included a constitutional provision that the budget be 'balanced'; expenditures could not exceed revenues plus counterpart funds generated by the aid program. This provision limited the crucial mechanism that had produced the hyperinflation: unlimited central bank emissions. It also signalled the willingness of the political leadership to insulate at least certain portions of the economic policy-making process, particularly for the purpose of enhancing the government's credibility with foreign investors and the international aid community.

This did not mean that the government had abandoned its interest either in structuring politics or in intervening in the economy; to the contrary. At the political level, the New Order regime was built on an explicitly corporatist model in which the parties—including even the ruling one—were downplayed in favour of vertical, state-sponsored interest organisations, including business ones. In contrast to South Korea, these bodies played no discernible industrial policy purpose. In part this was due to the technical weaknesses of the bureaucracy itself, a factor stressed in the 'state capacity' model; in part it was a function of the direct political control exercised by the government over business. Nor did the associations play any meaningful role in articulating and transmitting the collective or sectoral interests of business, even of indigenous firms. As a result, the complicated network of formal institutions was bypassed in favour of clientelistic linkages that favoured the largest firms. Among these were an important group of Chinese capitalists who developed a symbiotic relationship with the top political and military leadership.

The political structure also had a further consequence: patterns of intervention in the economy tended to be even more dominated by state enterprises than in Malaysia. This was particularly true during the heyday of the oil boom years, when full government coffers provided the opportunity for the 'engineers' within the economic bureaucracy to temporarily triumph over more liberal technocrats who favoured government restraint and a more market-oriented approach. In the 1980s, a new form of 'state' enterprise emerged in the form of nominally private firms held by members of Suharto's immediate family.

A consistent theme in studies of the Indonesian political economy is the crucial role that swings in oil prices have had for government policy (MacIntyre 1993). Booms favoured greater state intervention; foreign exchange constraints provided the motive for a more liberal policy stance. Yet MacIntyre (1991) argues that secular trends in the Indonesian political economy may come to play a more important role in supporting the trend toward liberalisation as the private sector begins to organise and to press its claims on the government. While business interests vary by sector, his assessment is that their demands are not necessarily limited to rent-seeking; rather, their interests increasingly lie in 'rationalising government regulation of business, limiting gross cronyism and promoting a more consistent and predictable legal framework'. Their concerns provide a good summary of the lingering weaknesses of the Indonesian industrial policy system.

CONCLUSION AND DIRECTIONS FOR FUTURE RESEARCH

At the broadest theoretical level, the essays in this volume confirm the need to move beyond the stale dichotomy of 'statist' and 'societal' approaches to economic policy and growth. Each takes the independent interests and capabilities of business more seriously than had been the case in the statist literature on Japan and the NICs. Yet all make clear that business operates in a political and institutional context which is not wholly of its own choosing, and that this setting is crucial for understanding economic policy.

Beyond such generalities, however, we are still left with the question, raised by MacIntyre in his introduction, of the extent to which the Southeast Asian cases confirm or call into question earlier 'statist' interpretations of the Northeast Asian cases. I believe the cases do confirm several key insights of the statist approach, but this does *not* mean that the Southeast Asian countries are necessarily following a similar policy or political model to their Northeast Asian counterparts. Indeed, as the many differences in industrial strategy and structure among the Northeast and Southeast Asian countries suggest, the quest for an overarching model that encompasses all of them is probably misguided.

I have argued that the statist interpretation of the Northeast Asian NICs has downplayed the extent to which political leaders were sensitive to, aligned with, or even dependent on, private sector support. On the other hand, the Southeast Asian cases appear to confirm the finding that *too* close an alignment between business and government can lead to capture, rent-seeking and the adverse consequences postulated by neoclassical political economy.

However, political institutions have an influence on the extent to which such a possibility will occur, and that is precisely the point of the institutionalist approach. Political institutions in Thailand provided access for business, but limited their control over the policy agenda, provided opportunities for ethnic rent-seeking in Malaysia, fostered personalistic ties between business and political elites in Indonesia, and provided virtually unchecked opportunities for plunder in the Philippines. As I have attempted to show, these institutional differences did have systematic effects on the outcomes under examination here, including both industrial policy and structure.

Despite these institutional differences, one of the most striking empirical finds that emerges from the country studies is the increase in the organisation and influence of the domestic private sector across all six cases. This should hardly be surprising given the spectacular records of economic performance in the region, but it raises the question of how a shift in the balance of political power between the public and private sectors will affect government policy in the future. In particular, what is the role of domestic private sectors in the current wave of economic reform that is sweeping the middle-income countries in Northeast and Southeast Asia?

Getting at this question demands a theoretically informed approach to business preferences, and it suggests one important criticism of the aggregate approach to the private sector taken here. The essays in this volume operate on the assumption that we can speak meaningfully about the political position or interests of 'business' as a whole. For some purposes, this is appropriate. 'Capital' does share some common interests, such as the protection of property rights, the provision of a stable business environment, and the design of a system of industrial relations that favours management interests. Differences in the power of 'capital' across countries should thus be associated with differences in policy outcomes.

Yet a growing body of scholarship is making it clear that the interests of different segments of business need to be disaggregated (Doner 1991a; MacIntyre 1991). Potential conflicts of interest include those between large and small firms, between upstream and downstream producers within particular commodity chains (Doner 1991b), between industry and finance (Haggard & Maxfield 1993), between import-competing and export-oriented industries (Rodrik, forthcoming), and between tradeables and non-tradeables (Frieden 1991). These conflicts of interest will play a crucial role in the politics of economic reform in the future.

It is worth noting, however, that the interests of business are closely related to past patterns of government policy. In Korea, Taiwan and Thailand, the policy regime encouraged the development of domestic private sectors strongly tied to world markets. The political voice of business in these countries is more likely to be raised in support of further liberalisation than is the case in the Philippines, Malaysia or Indonesia, where policy generated a stronger presence for domestic firms in the import-substituting and non-tradeable goods sectors. This suggests that governments willing and able to undertake the combination of economic reform and industrial policy required to move domestic firms into international competition will, in the process, create bases of political as well as economic support. This lesson is not a trivial one.

NOTES

1 My thanks to Alasdair Bowie, Rick Doner, Karl Fields, Chalmers Johnson, Linda Lim, Andrew MacIntyre and Chung-in Moon for comments on earlier drafts. Particular thanks to Edwin Winckler, who saved me from a number of embarrassing errors. Thanks also to Yun-han Chu, Ed Campos and other participants in a panel on the work of Alice Amsden and Robert Wade at the American Political Science Association Annual Meeting, 3 September 1993.

2 The quest for the taproot of rapid growth in the region has led to a focus on sociological variables (Vogel 1991), corporate structures and governance (Hamilton 1991), the changing geostrategic environment (Cumings 1984), the role of labour (Deyo 1989), the absence of natural resources (Ranis & Mahmood 1992), and culture (Berger & Hsiao 1988), to name only the major contenders.

3 The term 'institutionalism' has been claimed by a number of competing camps recently, and it is thus with some trepidation that I use the word in what will appear to some an idiosyncratic fashion. My earlier work has been associated with the 'statist' approach to the NICs, but I find this label somewhat confining since my approach has increasingly focused on the effects of a broader complex of political institutions, including not only the bureaucracy but the regime, the party system, the system of industrial relations, etc. (Haggard & Kaufman 1992). Others have emphasised that even this array of political institutions is too confining and that greater attention must be given to non-governmental institutions of various sorts (Doner 1991b). Institutionalist approaches, regardless of whether they are in the neoclassical vein (North 1990) or more historical share the assumption that the configuration of social interests cannot explain policy outcomes without reference to the institutional setting in which those interests operate. Institutionalism thus stands in contrast to at least the more reductionist Marxist and neoclassical approaches, as well as to any approach that gives primary explanatory weight to ideology or culture.

4 See for example the essays in McCubbins and Sullivan (1987).

5 This does not necessarily imply authoritarianism; democracies have to solve coordination problems as well, and have developed a variety of mechanisms for doing so. For a more extended discussion of the 'authoritarian hypothesis', see Haggard (1990: chapter 9); Haggard & Kaufman (1992).

6 Two recent innovations along these lines with reference to the Northeast and Southeast Asian countries are Doner (1991b) and Lee (1992). As

Doner points out, institutions other than central government ones can play the roles outlined here, including business associations.

7 This factor is emphasised in chapter 1 of this volume in MacIntyre's reconstruction of the 'statist' consensus.

8 Interestingly, this is true regardless of whether explanatory emphasis is placed on the liberal or more interventionist components of the policy mix.

9 This is the position taken by Johnson (1982) and Evans (1992).

10 For a general argument along these lines, see Levi (1988); on Korea see Haggard, Kim & Moon (1991).

11 This criticism of institutionalism has been made by Haggard & Moon (1990); Doner (1991b); Doner & Hawes (1992); Evans (1992); Wade (1992); Kim (forthcoming). I am particularly indebted to Chung-in Moon and Richard Doner for forcing me to rethink this issue.

12 This view has been advanced in recent debates about business–government relations in Japan. See particularly Samuels's conception of 'reciprocal consent' (1987: 8–9).

13 Among the mechanisms through which this might occur are reduced financial backing for political campaigns, investment strikes and capital flight. Note that the ability of private capital to flee is in part a function of the capacity of the state.

14 Originally the Korean Businessmen's Association.

15 In contrast to the Northeast Asian NICs, there are very few comparative studies of this sort on the ASEAN countries. Among the notable exceptions are Yoshihara (1988); Mackie (1988); Doner (1991a).

16 They could set ceilings on the level of taxation, but adjustments under those ceilings remained in the hands of the economic bureaucracy. The bureaucracy's discretion, in turn, was circumscribed by a number of rules that limited the government's capacity to spend (Warr & Nijathaworn 1988). A further check on policy was provided by the Central Bank, which despite its formal subordination to the Ministry of Finance had long enjoyed a history of independence.

17 Bello, Kinley & Elinson (1982) and Broad (1988) are examples. For three critiques, see Haggard (1989), Hutchcroft (1991) and Jayasuriya (1987).

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Index

Politics/Economics/Asian Studies

The unprecedented high-speed economic growth of key Asian states has been far more easily described than explained. Focusing on the core aspect of the process of national economic development—the relationship between business and government—this book compares the experiences of two newly industrialising economies of Northeast Asia, South Korea and Taiwan, with those of four Southeast Asian economies: Thailand, Malaysia, Indonesia, and the Philippines.

The ten original essays included here explore a range of aspects of the relationship between business and government in industrialisation. The first section introduces the theoretical debates on the state's role in the rapid transformation of developing economies. The following section includes detailed studies of government-business interaction in several states. A concluding essay, by Stephan Haggard, reexamines established ideas about the political economy of rapid export-led industrial development.

The Southeast Asian countries appear to be following the manufactured export-led economic trajectory of the Northeast Asian NICs. In fact, as this volume documents, they are doing so on the basis of major differences in the configuration of relations between government and industry.

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