

In Search of The 21st Century Developmental State

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IN SEARCH OF THE 21ST CENTURY DEVELOPMENTAL STATE ¹

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Abstract

What role for the developmental state in the 21st century? What state structures and political institutions will best equip nations trying to enter the ranks of “developed” countries? I offer two interconnected propositions. The first stresses continuity: the “developmental state” will continue to play a crucial a role in economic growth and social transformation in the 21st century, just as it did in the latter half of the 20th century. The second is more radical: successful 21st century developmental states will have to depart fundamentally from existing models of the developmental state in order to achieve success. Growth strategies focused primarily on traditional capital accumulation will no longer suffice. State-society ties can no longer be focused narrowly on relations with capitalist elites.

¹ This paper grew out of a Harold Wolpe memorial lecture presented in Johannesburg, South Africa in August of 2006. The current version has been substantially rewritten, but remains a draft. A similar version is forthcoming as a chapter in Stephen W.K. Chiu (ed.) *The Role of Government in Hong Kong*, University of Hong Kong Press. If you want to quote for publication please contact the author at pevans@berkeley.edu.

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

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

I will then review the models of the 20th century developmental state that were built around the studies of the archetypal cases of Korea and Taiwan by Amsden (1989), Wade (1990) and many others, including myself (e.g., Evans 1992; Evans 1995). The success of these developmental states still remains incontestable, whether the indicator is the Human Development Index (HDI), growth of GDP per capita, or more specific measures of industrial competitiveness. Following the perspective that I laid out a dozen years ago in *Embedded Autonomy* (Evans 1995), I will highlight two facets of the 20th century developmental state: bureaucratic capacity and “embeddedness.”

Following this discussion of the 20th century developmental state, I will try to summarize some of the shifts in the historical character of development that are particularly relevant to the role of the state. I will argue that the narrative of “development” that emerged out of the “golden age of capitalism” in the rich countries of the North was always partly mythical and can no longer be sustained. This vision, in which relatively comfortable lives for a broad cross-section of the population are anchored in the expansion of machine production and a “blue collar middle class,” never fit the realities of the Global South. In the 21st Century it is patently unsustainable in either the North or the South.

A narrative must be grounded in the fact that growth has become increasing “bit-driven.” Value added comes from new ways of arranging bits of information in formulas, software code, and images and less from the physical manipulation of materials to make tangible goods.³ Even in the global South manufacturing employs a shrinking minority of the population. Most people’s livelihood depends on delivering intangible services. For a

² By creating the UNDP’s Human Development Report with its “human development index,” ul Haq transformed the concept of “capabilities” into a standard empirical indicator; see ul Haq (1995).

³ Cf. Negroponte (1996).

small minority this means highly rewarded “business services.” For most it means poorly-rewarded personal services.

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

All of this has powerful implications for the institutional character of the developmental state, which I will develop in the final substantive section. Expanding investment in human capabilities depends above all on public investment. Allocating this investment efficiently requires much broader capacity to collect information. Implementation requires “co-production” of services by communities, families and individuals.⁴ The state-society ties required correspond nicely with the political propositions of new development theories, but stand in contrast those utilized by traditional developmental states.

In short, viewing shifts in the historical character of economic growth through the lens of modern development theory suggests that state capacity will have an even greater role to play in societal success in the coming century than it did in the last century. But, it also suggests that the specific kind of “embeddedness” or “state-society synergy” that was crucial to 20th century success – dense networks of ties connecting the state to industrial elites –will have to be replaced by much broader, much more “bottom up” set of state-society ties to secure developmental success in the current century.

The Recent Evolution of Development Theory

We have left behind the days when development theory was fixated on capital accumulation as the necessary and sufficient bedrock of growth. In what Hoff and Stiglitz (2001) call “modern economic theory”, “[d]evelopment is no longer seen primarily as a process of capital accumulation but rather as a process of organizational change” (Hoff and Stiglitz 2001: 389).

⁴ See Ostrom (1996).

There are two interconnected strands of the “modern economics” of growth. One is the “new growth theory” which emphasizes the increasing returns to ideas as the real key to growth. The other is the “institutional approach” which focuses on the key role of enduring shared normative expectations or “rules of the game” in enabling forward-looking economic action. If we combine the two, the central question for growth becomes, “What kind of institutional arrangements will best enable societies to generate new skills, knowledge and ideas and the networks needed to diffuse and take advantage of them?” I will start with the “new growth theory” (which has now been around for two decades) and then consider “institutional approaches.”

In the late 1980’s theories of “endogenous growth” or the “new growth theory,”⁵ helped re-orient theoretical discussions of growth. Its basic premises make intuitive sense. The dismal logic of diminishing returns, which limits development strategies based on physical capital (and even more thoroughly those based on land and natural resources), does not apply to knowledge and ideas. Since the cost of reproducing an idea is effectively zero, multiplying the use of valuable ideas generates returns that increase indefinitely with the scale of the market.

The new growth theory’s emphasis on the centrality of idea production (rather than the accumulation of physical capital) fits well with the comparative empirical evidence on growth that has been amassed over the course of the second half of the 20th century.⁶ There is, nonetheless, a still large residual in most growth equations which is usually labeled changes in “total factor productivity.”⁷ Trying to account for this residual has been one impetus for the institutional approaches that now dominate the mainstream of development economics.⁸

The third element in the renovation of development theory is the “capability approach.” Among all the recent contributions to development theory, the capability approach takes most seriously the universally accepted proposition that growth of GDP per capita is not an end in itself, but a proxy for improvements in human well-being, to be valued only

⁵ See Romer (1986; 1990; 1993a; 1993b; 1994) and Lucas (1988). For recent summaries see Aghion and Howitt (1998) or Easterly (2001: Chapters 3, 8, 9).

⁶ Elhanan Helpman (2004) provides one of the best surveys of this evidence. Private rates of return to investment in new knowledge are consistently higher than the rates of return to physical capital and social rate of return is much higher than the private rate of return. The effects of human capital are equally powerful. Putting ideas and education together Jones (2002) argues “between 1950 and 1993 improvements in educational attainments. . . explain 30% of the growth in output per hour. The remaining 70% is attributable to the rise in the stock of ideas . . .” [cited in Helpman (2004: 48)].

⁷ This represented a figure 80% in Solow’s (1956) original work, 60% in more recent work that includes human capital.

⁸ In their contribution to the *Handbook of Economic Growth*, Acemoglu, Johnson, and Robinson (2005), argue unambiguously for the thesis that institutions are the “fundamental determinants of long-run growth.” Dani Rodrik, in a co-authored paper called “Institutions Rule” (Rodrik, Subramanian, and Trebbi 2004), is equally straightforward: “the quality of institutions ‘trumps’ everything else.” Easterly and Levine (2003) and Bardhan (2005), among many others, offer further support for the primacy of institutions. See also Evans (2004; 2005; 2007), as well as Chang and Evans (2005).

insofar as it can be empirically connected to improved well-being. Sen argues that we should evaluate development in terms of “the expansion of the ‘capabilities’ of people to lead the kind of lives they value – and have reason to value.”⁹ Because it rejects reduction of developmental success to a single metric, the capability approach identifies “public deliberation” as the only analytically defensible way of ordering capabilities puts political institutions and civil society at the center of developmental goal-setting.

There is also an interesting convergence between the capabilities conceptualization of development and the new growth theory. Sen emphasizes that the expansion of capabilities is simultaneously the primary goal of development and a principle means through which development is achieved. The emphasis of new growth theorists on the knowledge and skills embodied in the capabilities of individuals (and the networks that connect them) as key inputs to growth, buttresses the idea that “capability enhancement” is a principal input to growth.¹⁰

At the same time, there is a different sort of convergence between institutional approaches and the capability approach. Advocates of the institutional turn are increasingly focused on the causes and consequences of the kind of collective goal-setting that Sen (1999a; 2001) puts at the center of the capability approach. Rodrik (1999), for example, argues that democracy is seen as a “meta-institution” promoting the “high-quality institutions” which in turn promote growth.

What are the implications of taking these strands of the “modern economics” of development and applying them to the question, “What is the most effective role for the state in the process of development?” These theories give central importance to institutions that set collective goals, provide collective goods, and maintain general rules and norms, vindicating those that have argued that the effectiveness of state institutions is central to developmental success. But, we need to go beyond this generic assertion. In order to derive more specific implications, we need to first review the institutional character of the 20th century developmental state.

The 20th Century Developmental State

To understand the implications of new development theories for the 21st century developmental state, we must set them in the context of existing models of the 20th century developmental state. While a variety of 20th states have played important roles in promoting development, theorizing with regard to the 20th century developmental state has drawn most heavily on post World War II East Asia (e.g., Amsden 1989; Wade

⁹ Among Sen’s massive bibliography, *Development as Freedom* (Sen 1999a), is perhaps the most accessible synthesis.

¹⁰ Key examples include Boozer, Ranis, Stewart, and Suri (2003) and Helpman (2004).

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

To focus on the East Asian developmental states is to focus on the importance of the capacity of public bureaucracies. Nearly everyone agrees that when East Asian public bureaucracies are compared with those of developing countries in other regions they more closely approximate the ideal typical Weberian bureaucracy.= Meritocratic recruitment to public service and public service careers offering long-term rewards commensurate with those obtainable in the private sector were institutional cornerstones of the East Asian economic miracle.¹²

A few years ago, Jim Rauch and I undertook a simple empirical exercise to confirm the importance of bureaucratic capacity (Evans and Rauch 1999). We collected estimates of the extent to which the core organizations of economic administration in a sample of developing countries, conformed to the basic features of true bureaucracies as originally identified by Max Weber: whether recruitment to public positions involved impersonal meritocratic criteria, whether those recruited into these organizations could expect long term career rewards that approximated those available in the private sector, providing they performed well, and so on.

In our sample of developing countries, the results from investments in improving bureaucratic capacity were very large. Roughly speaking, an increase of one half of a standard deviation in the “Weberian” score is worth a 26 percent increase in GDP from 1970 to 1990 (controlling for human capital and initial GDP per capita). Likewise, an increase of one standard deviation in the Weberian score is roughly equivalent to a shift in average years of education in 1965 from 3 years to 6 years (controlling for initial GDP per capita).

Despite the centrality of bureaucratic capacity, no student of the 20th century developmental state assumed ivory tower bureaucrats constructing policy in isolation from society. Given a capable, internally coherent state bureaucracy, the next challenge was connecting bureaucrats and corporations. In East Asia, the connection was made on at least two quite different levels. On the most general level, East Asian governments managed to generate a sense that they were genuinely committed a collective project of national development. Despite political divisions and governmental missteps, this sense

¹¹ The literature on the 20th century developmental state is vast. For more recent analyses see Chibber (2003) and Kohli (2004). Likewise, Johnson’s (1982) pioneering analysis of Japan should not be forgotten.

¹² By the 1990’s, even the World Bank (1993; 1997) had joined the consensus.

of a national project gained surprisingly widespread credence and constituted one of the most important "collective goods" provided by the state. The essential complement to this broad ideological connection was a dense set of concrete interpersonal ties that enabled specific agencies and enterprises to construct joint projects at the sectoral level. "Embeddedness" is as central to the standard portrayal of the 20th century developmental state as bureaucratic capacity.

Embeddedness was never a tension-free symbiosis. Based on the prior performance of local business, state officials assumed that the private sector's "natural" strategy was "rent-seeking," looking for officially sanctioned niches that would allow them to buy cheap and sell dear without having to brave entry into newer, more risky sectors. Therefore, the developmental state had to avoid being politically captured by their partners, in order to keep private elites oriented towards national projects of accumulation rather than their own consumption. Maintaining dense ties to entrepreneurial elites while avoiding capture and being able to discipline them¹³ is a defining feature of East Asian development states, distinguishing them states from less successful states in Asia and Africa (see Kohli 2004).

East Asian's crucial ability to maintain autonomy from local industrial elites was not simply the fruit of bureaucratic competency and coherence. The revolutionary violence and chaotic geopolitics of mid-20th Century had the developmentally propitious consequence of wiping out landed elites as politically effective class actors in national politics in post-World War II East Asia. Local industrial elites were weak both economically and politically and transnational capital largely absent from domestic processes of accumulation. Consequently, it was possible to construct a form of embeddedness in which national projects of transformation carried strong weight relative to the particular interests of private actors.

Despite the ambivalent character of the 20th Century developmental states relations with industrial elites, ties to these elites were not balanced against connections to other social groups. To the contrary, civil society as a whole was excluded from the process of "state-society synergy." Private industrial elites were seen as key collaborators in enabling industrial transformation as well as key sources of information regarding the feasibility of specific industrial goals. Other social groups were peripheral, if not threatening to this exclusive state-society partnership.

The basic vision of the 20th Century developmental state remains compelling. A coherent capable state apparatus is paired with dense ties to private entrepreneurial elites to produce forward-looking investments that enhance productivity, grow incomes and lead to increased well-being. This narrative is certainly consistent with the "institutional turn" development theory, which emphasizes that functioning markets require a complex of underlying institutional arrangements in which the state is likely to be central.

¹³ Particularly emphasized by Amsden (1989).

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

A Historical Shift in the Character of Development

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

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

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

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

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

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

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

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

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

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

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

Other successful manufactured exporters in the Global South confirm this general picture. In Brazil, for example, manufacturing's share of peaked by accounting for 1 in 5 jobs in 1980's and began to decline at the end of the 1990's, while service jobs came to account for the majority of employment. In South Africa the story is the same. Manufacturing peaks at about 1 job in 6 at the end of the 1990's and services become the source of livelihood for the majority of the workforce.

A Global South in which manufacturing employs a shrinking minority of the population while most depend on the service sector undercuts the 20th century story of increased general well-being built around machine production. To figure out what new narrative makes sense, we must go beyond shifts in the structure of employment to the changes in the distribution of economic opportunities and returns that underlie those shifts.

Fundamental to the changing profile of economic activity is "bit-driven growth," growth which is driven more by ideas and information (both as means of production and objects of consumption) than by the physical transformation of nature.¹⁴ Bit-driven growth's rising role corresponds to the theoretical propositions of the "new growth" theory and econometric observations of differential returns in the latter half of the 20th century which show growth and productivity as driven primarily by changes in the stock of ideas and in people's capacity to take advantage of them (i.e., levels of education and training).

The possibility of indefinitely increasing returns creates unparalleled possibilities for profit, especially in a global market: possibilities which accrue primarily to Northern corporations who have secured proprietary rights to the most profitable ideas. The tendency for higher returns to accrue to ideas and information is also reflected in the changing bases of profits within sectors that produce tangible goods. In manufacturing, design on the one hand and market on the other become key sources of high returns. The returns to command over information and communications technology are further reinforced by "financialization" (Krippner 2005), the tendency for financial returns to take increasing priority over returns from the so-called "real" economy, even among corporations that are ostensibly "industrial" firms.

The increasing importance of "intangible assets" (ideas, brand images, etc.) has, in turn, powerful political implications for the role of the state. Securing the appropriation of returns from ideas is notoriously difficult, requiring intensive, politically enforced

¹⁴ The terms is from Nicolas Negroponte's (1996) observation that economic activities is less and less driven by the rearrangement of atoms (i.e., the physical transformation of goods) and more and more driven by the rearrangement of "bits" that is so say, information, ideas and images.

protection of monopoly property rights. Consequently, for the most powerful economic actors in a bit-based economy, the key role of the state is maximal enforcement of their monopoly rights to returns from their intangible assets.

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

There are negative distributional implications as well. The political protection of monopoly rights to productive ideas restricts people’s access to the key tools, diminishes their ability to make use of their own “human capital,” reduces the number of actors who can participate in the overall process of innovation. Without politically imposed restrictions on the use of ideas, entrepreneurially inclined citizens could have access to the intangible equivalent of a variety of steam engines (Weber and Bussell 2005), a vision which is perhaps best exemplified by the case of open-source software (Weber 2004).

The contradiction between providing monopoly protection of traditional property rights and expanding people’s access to productive opportunities is particularly sharp in the Global South. “Human capital” is the South’s most abundant potential economic resource, and its current underutilization is much more severe than in the rich countries of the North. Markets are even less likely to invest in human capabilities in the South than in the North. Conversely, current political protection of monopoly control over ideas benefits Northern corporations at the expense of Southern access. Monopoly returns to intangible assets create a drain on the South’s resources as they flow to corporate headquarters in the North. As Ha-Joon Chang (2002) points out, the historical response of governments in the North to this dilemma was essentially to ignore the property rights of corporations based outside their borders. Today’s increasingly globalized property rights regime makes it more difficult for governments in the Global South to take advantage of this obvious strategy.

¹⁵ Opponents of this position will argue that the incentive effects of expected monopoly returns increase the output of new ideas and outweigh the negative effects of subsequent restricted access. How the balance works out in practice depends on specific institutional contexts. In the case of medications, for example, the evidence would seem to support the negative consequences of enforcing monopoly rights. See Angell (2004) for a popular but well-argued exposition.

Taking into account bit-driven growth and the increasing focus of profits on intangible assets and financial assets helps illuminate the consequences of the service sector's dominance as the source of modern employment. From the point of view of workers' incomes, the service sector is bifurcated. For a small minority of service sector workers, employment constitutes an opportunity to share in the returns from intangible and financial assets. Privileged workers in the business and financial services sectors and the "symbolic analysts"¹⁶ who manipulate key information in other sectors enjoy a comfortable share of the returns from "bit-driven" growth. For the vast majority of those who work in the service sector, the situation is very different. Most service sector workers are engaged in delivering some kind of inter-personal services – ranging from retail trade to education to health. The bulk of these jobs are under rewarded.

For most workers, the current shift from employment in manufacturing to service sector jobs lacks the promise of the earlier shift from agriculture to industry. A narrative built around the shift from an industrial to a service economy seems likely to be marked, not by the creation of a new, relatively affluent working class, but by expanding inequality and stagnating wages for the majority of workers.

Looking at the disprivileged majority of workers in the bifurcated service sector also points to a contradiction between the way the service sector is structured in practice and what might be considered optimal from a capability perspective. If the expansion of human capabilities is both the key means and central goal of development, then rewarding capability-expanding services and increasing their supply should be a developmental priority. Yet, in practice, capability expanding services like health and education are undersupplied as well as under rewarded.

This is hardly a paradox from the perspective of market logic. Since social returns to the expansion of human capabilities are substantially higher than private returns, private markets consistently and perennially underinvest in human capabilities. Instead, markets channel investment to other areas where total returns are lower but private returns appear higher. This is particularly true in the case of the most fundamental capability expanding services. Early childhood education, where the capabilities generated will have an impact on production only in the distant future, is the best example.

When capability arguments are connected back to "new growth theory" arguments, the disjunction between market logic and developmental logic becomes even more apparent. Ideas are generated in human heads and through their interaction, expanding human capabilities is part and parcel of accelerating growth in the stock of ideas. Yet, for a private investor, investing in a human being is a much riskier than investing in machines.

Machines are very likely to do what they are supposed to do. People make choices (constrained choices, but choices nonetheless). No one who "invests" in a person's capabilities can count on their "investment" choosing to eventually exercise their

¹⁶ The term is Robert Reich's (1991).

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

All of this brings us back to the third stream of developmental theory – institutional approaches to development. Looking at the changing historical character of development in the 21st century from the perspective of both the new growth theory and the capability approach, suggests that 20th century institutions are going to need substantial overhaul if they are to confront the challenges of 21st century development. Among the institutions challenged by the shift in the historic character of development, the state stands in center stage.

The Challenge of Transforming the Developmental State

If the developmental state was important to 20th century economic success, it will be much more important to 21st century success. New theoretical perspectives have alerted us to the underlying reasons for state’s increasing importance. Historic changes in the character of the economy have increased the salience of the state’s role, making it more difficult at the same time.

Citizens of the South, even more than citizens of the North need aggressive action by entrepreneurial public institutions if they are to realize their potential productivity and enjoy the levels of well-being that the 21st century economy is capable of providing. Since the core 21st Century challenges are issues of political economy, reconstructing political connections to society will be fundamental to the state’s ability to shift strategies.

The basic arguments for the increasing importance of the state’s role have already been set out. Accelerating economic growth in 21st century requires expanding access to the existing stock of ideas, increasing effective utilization of this stock and generating of new ideas suited to a country’s specific circumstances. All of this depends on the expansion of human capabilities. Left to themselves markets will not deliver an optimal supply of capability-expanding services. Only aggressive and efficient entrepreneurial engagement by public institutions can deliver what is needed. At the same time, states must find ways to resist the traditional logic of political economy which pushes them to overprotect monopolies control of the existing stock of ideas, restricting access and utilization and thereby reducing both growth and well-being.

The most obvious starting point for more aggressive state action is ramping up the effective delivery of capability-expanding services. Since all modern states play a central role in the provision of health and education, this is a task which public institutions

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

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

20th Century developmental states are also interesting cases with regard to accelerating the production of ideas and expanding access to the existing stock of ideas. "Industrial policy" in both Taiwan and Korea was never restricted to subsidizing investments in plant and equipment. It always focused on increasing the access of local firms to productive ideas and creating networks and incentives to push entrepreneurs towards a greater emphasis on the production of new knowledge. In addition to finding ways to transplant and exploit the stock of knowledge that was ostensibly the property of Northern corporations, the East Asian Tigers, like China, resisted the overprotection of ideas monopolized by Northern corporations, leading to cries of "piracy" from the North, but expanding the access of their citizens to productive ideas.¹⁷

Finally, these states had another capacity critical to capability expansion. They were able to extract revenues from their own private elites at a level sufficient to maintain the integrity of their own apparatuses and finance necessary investments in capability-expansion. As E.V.K. Fitzgerald (2006) has pointed out, one of the principle differences between Asian developmental states and their less successful counterparts in Latin America, is the inability of the latter to tax their own elites, despite the fact that elites in Latin America appropriate larger shares of the collective national product for themselves (see also Di John 2006). Having the organizational capacity and political will necessary

¹⁷ In this respect, as Chang (2002) underlines, 20th century developmental states followed the earlier historical practice of states in the North.

to collect adequate revenue was the pre-requisite to investing in both capability-expansion and industrial transformation.

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

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

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

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

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

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

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

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

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

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

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

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

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

On all dimensions, comparisons of the requirements for 21st century success with those of 20th century success are sobering. To be effectively developmental, the 21st century state must take more responsibility, achieve greater autonomy in relation to private elites and construct more complex and demanding forms of embeddedness. Given that only a small set of states managed to merit the label of “developmental,” what are the prospects of the emergence of 21st century developmental states?

Conclusion: Prospects for a 21st Century Developmental State

Claiming to predict the precise institutional forms that successful 21st century developmental states will adopt would be foolish. Hegel’s dictum that “the owl of Minerva spreads its wings only with the falling of the dusk” is as true in this case as in any other. The role of the 20th developmental state in the economic transformation of the East Asia Tigers the period from the end of World War II through the 1980’s was neither fully appreciated nor effectively incorporated into theories of development until the beginning of 1990’s. Effective understanding and theorization of the role of the 21st developmental state is likely to arrive only after its effects are already being experienced.

Nonetheless, would be even more foolish to assume that we can contribute to useful theory or effective policy simply by sticking with old models, analyzed in terms of past theoretical formulations. The owl of Minerva should not be an excuse for resting content with analyses we know are outmoded. Starting with an appreciation of how theory and the historical character of development itself are changing, there is no escape from trying to formulate plausible propositions on how the state must change in order to enjoy success in the century to come. Some firm conclusions are possible.

Neither new theories of development nor recent transformations in the character of economic diminish the centrality of the state as a developmental institution. The vision of bureaucratic capacity as one of the keys to effective state involvement that was established in analysis of 20th Century developmental states stands fully intact. So does the key role of state-society ties. Beyond these reassuring general continuities, new theories and a new historical context impose severe demands institutional change.

The “new growth theory” forces development policy to focus on ideas and knowledge. The “bit-driven” character of 21st century growth implies an expansion of the state’s role relative to what was required by the “machine production” of 19th and early 20th century growth. Economic marginalization will be the fate of countries that lack public effort and investment in an era of bit driven growth. Ensuring maximum possible access to ideas that are tools for the further expansion of knowledge requires active state involvement, sometimes in opposition to the private owners of those assets. In short, to facilitate 21st century bit-driven growth, the state must be agile, active, resourceful and able to act independently of private interests whose returns depend on restricting the flow of knowledge.

The capability approach dovetails with the new growth theory and further expands the demands on the state. The bureaucratic capacity required for the delivery of capability-expanding collective goods must be joined with the very broad range of state- society ties necessary for the effective delivery of capability-expanding services.

Institutional approaches to development remind us that these changes cannot be achieved simply by re-formulating policy goals. Transforming public institutions is the only way to produce a state with the capacity to meet 21st Century requirements. Bureaucratic and organizational capacity is crucial but in order to deliver they must be coupled with new political capacities. Institutional approaches and the capability approach convergence around the centrality of democratically deliberative institutions to developmental success. For the capability approach, deliberative institutions and the broad based connections between state and civil society that they entail are the only way to ensure either the flows of information necessary to guide the allocation of public resources or the “co-production” necessary for the effective delivery of capability expanding services.

Realistically, no 21st century state is likely to fully achieve the required transformation, not even those that best managed to meet 20th century requirements, but this should not be taken as a pessimistic conclusion. As in the case of the 20th century developmental state, even very partial approximations to ideal typical institutional models can deliver impressive results. Celebrating whatever institutional changes make the state more capable of meeting 21st century demands makes more sense than bemoaning the difficulty of achieving all the requisites of the ideal type. Unless contemporary development theory is completely misguided, countries that do manage to move in the direction of the required institutional transformations will be rewarded with more productive and

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

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