Theses of the Doctoral (PhD) Dissertation

The Survival of the Developmental State in Globalization

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I. Introduction

During the 2007-2009 global financial crisis the role of the state has acquired more importance in economic procedures. Such global economic developments bring especially about the study of the Asian developmental states, because the only truly successful government conducted industrial program occurred in such Asian states. Moreover, Asian economies faced serious crisis in the 90s, which meant the end of previously used developmental models. Therefore, in this research, I am attempting to find answers to the following question: how and in what context can the Asian developmental state survive in the globalized world?

In what follows I present the background of the research, that served as starting point for the theses of this dissertation, through presenting the scientific literature. Then the used methodology as well as the structure of the work will be discussed. Finally I will present the theses.

II. The relationships between the state and the interest groups

Defeating the obstacles of late industrialization served as a great topic of interest for the researchers of social sciences even from the beginning of Europe’s industrialization. The scientific literature of state conducted industrialization dates back to the work of Friedrich List. He highlighted the protection of “young industries,” that is, market protection and temporary import substitution in helping the increase of late industrialization, so that he practically went against 19th century economic opinions (Cumings, 1984: 5). The industrialization of continental Europe started only in the 19th century. The features of such late industrialization were different from the English experiences. English industrialization occurred gradually as well as spontaneously, in a longer period of time, without state intervention. Contrastingly, the late industrialization of continental Europe demanded state intervention. However, regarding the degree of state intervention we have to make differences between Western and Eastern European states. In the process of Western catching up state intervention was limited to creating the possibilities for quick development. Financing industry development based on acquiring advanced technologies was made by long-term planning banks, due to the shortage of financial resources and public distrust
(Gershenkron, 1962: 11-14). In contrast with Western-European experiences in Western Europe industrializations occurred with the help of direct state involvements. The level of economic and social underdevelopment did not make it possible that market participants should conduct industry development. Following the success of state interventions there appeared quick changes in society as well. Business behavior imitated Western patterns, investments projects were financed from the market (Ibid: 19-22). That is, according to European experiences, the more an industry is located in the “periphery,” the greatest role the state should have in launching the development.

Discussing the particular elements of Latin-American development Hirschman (1968) makes a difference between the late industries of 19th century Western-Europe, and the industrial experiences after that. In the case of these “late-late” industries, the researcher finds out significant challenges of development. Hirschman mentions among economic challenges that, because of the low level of development, there is no national industrial basis, onto which a modern industry could be built, such as it was created in the case of Germany at the beginning of its industrialization (Hirschman, 1968: 7). The early successes of import-substitution strategy, that had as its purpose the ceasing of economic underdevelopment, could have made possible the concerned countries’ export-oriented development. The fact that this did not happen, is beyond the economic difficulties. The Latin-American states’ inability to compete on the market might be due to certain social and political contexts, as the researcher points out. The import-substitution policy was based on the control of exports and the overpriced exchange rates. The control of import protected the national industry from foreign competitors, and the overpriced exchanged rates made it possible to import cheap industrial equipment and food. Import substitution, then, made income transfers possible from the direction of the landowner elite from the countryside to the urban industrialized elite. Because of the fight between the elites conducting a coherent economy policy became impossible, and this resulted in the so called stop-go policy. The political insecurity stemming from such conflicts of interest was not beneficial for long-term investments necessary in export-oriented industrialization, thus the industrial elite continually chose import substitution, which involved less risks (Ibid: 27-28). Because of low export performance account deficits occurred, while, because of the growth of state involvement, budget deficit occurred (Fishlow, 1990: 63-64). In order to decrease the expenses of the import substitution model the industries concerned attempted to diversify their export in the
1960s. But, because the state’s autonomy in contrast with interest groups was not realized, they started another stage of import substitution, according to the aforementioned stop-go policy (Haggard, 1986: 357-358). From the point of view of the developmental state, it is crucial to guarantee the autonomy in contrast with the social interest groups (Evans, 1995).

The above presented concise overview highlighted the key role of the relationship between the state and the interest groups regarding the success of developmental policies. If interest groups can have a significant influence on the state’s industry policy, the economy will be characterized by being excluded from competition in the long-term, low efficiency, and indebtedness. In this dissertation I intend to discuss these ideas further through the experiences of successful Asian industries.

III. The relationship between the developmental state and globalization

The two most important institutional means of the developmental state were market coordination and comparative advantages. In case of market coordination the state, through its bureaucratic agencies, redirected the resources of the closed capital towards the selected sectors. In case of generating comparative advantages the state, while introducing strong customs protection, used the profits from previous exports to develop new industries that represented higher levels of development (Vigvári, 2009: 130-137). In the 90s, due to the accession negotiations with various international organizations (GATT/WTO, OECD) the possibility of using the aforementioned means faded away. There was no possibility to control the capital flow, and customs protection as well as export subsidies were removed from the tools of the developmental state (Ibid: 139). In what follows I will present the oppositions between the monetary institutions of the developmental state and globalization processes.¹ These are crucial to my thesis, since the functioning of the developmental state is, in fact, based on a closed capital account.

¹ According to the definition of the World Bank, globalization means the integration of the countries in world economy towards a global market in terms of commerce, financial issues, labor, and ideas. The most important factors of this integration are the flows of international trade and investments (Soubbotina and Sheram, 2000: 66).
Globalization processes led to the increase of the debts on the part of corporate customers, and, for this, one can hold responsible the shortcomings of the monetary regulations. Shortcomings can be traced in credit assessment, forecasting and risk assessment. Monetary institutions functioned in spite of the low levels of capital indicators, banking supervision was weak, and transparency was not adequate (Goldstein and Hawkins, 1998: 24-25). After the collapse of the Thai Baht’s exchange rate in the summer of 1997 tense situations appeared in the region which led to a serious economic crisis. Because of speculative attacks the National Bank introduced a floating exchange rates system on the 2nd of June, 1997, a step that led to devaluation wave among the countries in the region that were in close economic relationship (Haggard, 2000: 1-7). The monetary institutions that functioned next to the closed capital account did not meet the requirements of financial globalization. Due to the weak regulations the external speculative capital got increased in the monetary systems of Asian countries, which led to serious economic crisis.

Because the national companies got access to the international capital market, there was no longer any possibility for coordinating the market. The new industrial branches were not sustainable without customs protection and export subsidies. Thus, the developmental state’s traditional institutional system could not function in globalization; it needed reforms. For institutional reforms the 1997-1998 Asian financial crisis provided opportunities. Pirie (2005) claims that in Korea, after the crisis and due to IMF reforms and political changes the developmental state ceased to exist (Pirie, 2005: 25-28). In regard to this Lee and Han (2006) argue that there was a paradigm shift in the leading role of the state. The increasing economic roles of external investors make the restoration of the developmental state impossible. However, the complete destruction of the developmental state is a long process (Lee and Hann, 2006: 321-323). It is obvious that there are many questions about the further functioning of the developmental state. It is unclear, whether we can even speak about a developmental state after so many institutional changes resulting from the crisis.

IV. Research questions

As one could see from the previous summaries, for the functioning of the developmental state internal and external factors are equally important. The embedded autonomy of the state as opposed to social groups brings about the implementation of developmental plans. However,
in the globalized world economy the traditional institutional system of the developmental state could not function. Based on these facts, the dissertation attempts to find the answer to the question: how can a developmental state survive in a globalized world? In answering this question I illustrate the transformative mechanism that appeared with the help of the experiences of the developmental state and the theories if social groups, a mechanism that shows us the development of democratic processes in the case of an authoritarian state.

V. Methodological characteristics of the dissertation

I answer the research question through case studies with the help of comparative analysis. First, I shape up a theoretical framework, which will be able to describe the relations between the interest groups and the developmental state. This theoretical framework is based on the Olson- and Putnam group theories, as well as their critical reception. After reviewing group theories, I conclude that the strengthening of interest groups is responsible for the transition, the slow democratization of authoritarian regimes through natural (that is, organic) development. In this way, resulting from the quick economic growth of the authoritarian regimes, the bargaining power of social interest groups against the state increases, which, according to North (1989), Olson (1993) and North et al. (2006), launches pluralist processes. The shaping up of inclusive institutional systems (Acemoglu and Robinson, 2013) stimulates trust on the social level (Knack and Keefer, 1997).

Confidence in institutions allows that such institutions can operate effectively. Long-term planning becomes possible, which is beneficial for economic activity. Economic successes further strengthen the confidence in institutions, bringing about the angelic circle of trust and success. In contrast with this, in an environment characterized by low-confidence, short-term planning and excessive risk aversion are dominant in economic processes. Economic failures further strengthen the distrust in institutions (Győrffy, 2013: 31-34). According to the transformative mechanism the inclusive institutions are favorable to the development of civic groups through economic development (Coats and Heckelman, 2003), which, after all, leads to the completion of democratic processes (Putnam, 1993).

Such idealized form of social development is shown in Figure 1.
I will illustrate the findings of my mechanism through case studies that present the experiences of South Korea and Singapore. The two developmental states provide an excellent opportunity for comparison, since they can be considered the so called “most similar case.”

According to the method of the “most similar case,” the chosen cases, with the exception of one, are similar in terms of each independent variable. Since during the analysis only one
independent variable and the output value are different, it can be assumed that the different final consequence is the result of the different variable (Seawright and Gerring, 2008: 304).

In the case of our subject, South Korea and Singapore, most independent variables are the same. The authoritarian developmental states started an export-oriented industrialization in the mid 1960s because of exterior threat, making use of the commercial possibilities that occurred due to the Cold War-time geopolitical situation. The successes of the strategy appeared in the modernization of industrial structures, in quick and long term economic development, as well as in the development of living conditions and human capital. There is only one difference between the two industries, that is, their industry policy at the beginning. While the Korean developmental state put accent on the loans of national corporations and state governed financial institutions, the industry policy of Singapore focused on the attraction of transnational corporations (Kim, 2004; Huff, 1995). This initial difference led to the different experiences of the developmental states through its effect on the evolution of interest groups. Because of the two different means, the two economies’ interior interest groups developed differently, and this had an effect on politics as well (Minns, 2001; Pereira, 2008). This difference gives ground to our comparison. During our analysis we will demonstrate the developmental experiences of the two economies through long term statistic data. In light of our theoretical framework and through comparing the long term developmental patterns we can already draw conclusions regarding the factors of the developmental state’s survival.

It is worth mentioning that the process described in our theoretical framework, following the 1997-1998 Asian financial crisis, is different from the traditional case studies. It seems that during the crisis the state reacquired some of its autonomy against the social groups. The appearance of the regulatory state and the full democratic transformation are still awaited. The difference between the theoretical thoughts and the experience provides the opportunities for us to give answers to the context-sensitive questions.

Because my analysis primarily views the context of Eastern Asia, the argumentation related to the two cases has to have adequate explanatory power, especially if we take into consideration, that the successful Asian developmental states include Japan, Taiwan, Korea, and Singapore.
VI. The novelty of the theses

During the research we would like to provide theoretically based explanations. The dissertation discusses the changing relations between the developmental state and the social interest groups in the light of the group-theories, thus it is not only able to explain the erosion of the developmental state in the 90s, but also looks at the conditions of functioning of the relations between the developmental state and globalization. Moreover, the theoretical framework provides the possibility of extending the research, looking at the (possibly) complete transformation of the developmental state.

The novelty of the dissertation lies in the shaping up of a theoretical framework that was designed with the help of group theories, which, using the case studies as illustrations, is able to describe the process of development of the developmental state with the help of internal factors, and attempts to provide answers to the questions formulated in the thesis statement.

VII. The structure of the dissertation

In the 2nd chapter of the dissertation I shape up the theoretical framework. In order to define the internal connections of the developmental state I draw upon the Olson- and Putnam group theories. At the end of the chapter, and based on the results of group theory I will create a mechanism that will be able to explain and describe the evolution of the developmental state.

In the 3rd chapter I discuss the theoretical questions of the Asian developmental state from historical and global-political perspective. The experiences will be discussed according to my theoretical framework. Throughout the chapter I will state my hypothesis, that will be illustrated with the help of case studies.

In the 4th and 5th chapters I will illustrate the questions raised earlier by the theories with the help of case studies regarding South Korea and Singapore. The analysis of the two developmental states and the interrelation between the internal interest groups bring about important conclusions. The case of Korea proves the hypotheses of the self-liquidating evolution model. The industry policy based on national economic operators, if it is successful, results in the deconstruction of the developmental state and launches pluralist processes. However, during the Asian crises interest groups became vulnerable, which was good for the strengthening of the state’s autonomy. In contrast with this, the case of
Singapore proves that the authoritarian developmental state can survive in globalization, if, during its industry policy, it does not create such social forces that can later have claims on the state.

In the 6th chapter I will sum up the findings of the dissertation and will draw up the final conclusions. Regarding the survival of the developmental state I call attention to the new possibilities for developmental states created by globalization, especially the change of the interest groups’ bargaining situation, the appearance of new groups, the FDI attraction, as well as the importance of building a strong institution system.

VIII. The theses of the dissertation

The example of Korea proves that due to the activity of a state that has strong autonomy and well defined developmental goals the negotiating position of the oppressed interest groups increases in time. Thanks to the high degree of the concentration of industry in Korea, labor unions started to flourish in the 60s against all bans. The next decade was characterized by regular workers’ demonstrations, which were joined by other social groups. When the strengthening middle class joined these demonstrations, these strikes, which were already class-based and aimed at improving the living and working conditions, started to acquire an oppositionist feature. The regular mass demonstrations caused the weakening of the Park regime (Kim, 2004). Despite the Chon dictatorship (that followed the Park regime) had put in place severe restrictions against the laborer unions, the demonstrations continued in the 80s, causing regime change and initiating democratic processes. Another important internal factor in the deconstruction of the classical developmental state was the chaebols. The big corporations that already had great influential power started an expansion based on foreign loans, as a result of the liberalization efforts of the 80s (Amsden, 1989; Minns, 2001). The debt accumulation in the 90s made the economy vulnerable to the effects of the Asian financial crisis, completing in this way the long-lasting deconstruction of the institutional system of the classical developmental state (Shin, 2005).

Due to the rise of the negotiating positions of interest groups democratic processes have started which, in their turn, contributed to the entering into various fields of economy and politics. All of these brought about a very quick economic development. Thus, political
changes influenced economic life, setting up the first circular process that was mentioned in the theoretical framework.

According to the mechanism designed in the second chapter, the strengthening of social interest groups leads to the launching of pluralist processes. The experiences of the 90s prove this hypothesis. At the same time, the completion of democratic processes and the complete discard of the developmental state’s political solutions are still awaited. During the Asian financial crisis the interest groups weakened and lost their social legitimacy, which resulted in the strengthening of state autonomy (Cherry, 2003; Hundt, 2005). The interventions that occurred after reclaiming the state’s autonomy meant the limitations of economic freedom, which, in the case of an open access policy caused the limitations of democracy (Kapás and Czeglédi, 2011). This is why the transformational mechanism that was mentioned in the theoretical framework has stopped.

So, the avoidance of the dangers lurking in globalization as well as market failures presupposes the existence of strong institutional system and state involvement. Moreover, in order to maintain the competitiveness of the developed industrial society that previously appeared due to the successes of the developmental state, the stimulation of FDI inflows became necessary, which, again, needs state intervention. Because SME-s play decisive role in the innovative sectors nowadays, the rise of new, smaller enterprises may further strengthen state autonomy (Kalinowski, 2008). The stimulation of FDI presupposes the use of institutional solutions similar to the Singapore-case in order to introduce innovative sectors (Thurbon and Weiss, 2006). Then, the memory of quick economic growth generates a social demand for the developmental state to continue its policies, so the civil society accepts the slower democratic processes (Kalinowski, 2008). So, the increase of state autonomy subsequently led to the rise of the developmental state. This slows down the development of democratic processes through civil organizations. Based on this, it seems that the developmental state can function in globalization if state autonomy exists.

Contrastingly to Korea, in Singapore the developmental elite could maintain their power. The negotiating power of the internal interest groups did not strengthen despite economic successes, so that social processes that could have led to the change of elite or pluralist “rotation” did not begin.
The economy of Singapore is fundamentally based on FDI and state-owned enterprises. The elite lead Singapore according to the world economy’s needs and possibilities (Huff, 1995; Pereira, 2006; Yeung, 2000). So that strong, private national industrial groups could not appear, even is the developmental state was successful. Because of the lack of national industrial elite the welfare of workers depends on state policy, so that the bargaining power of the state remained strong (Pereira, 2008).

The fast economic development in the period of labor-intensive industrialization did not lead to the strengthening of the interest groups as in the case of Korea, therefore the circular process between economic liberalization and democracy did not occur. Because the pluralist transition does not occur, according to my mechanism, civil organizations are not dangerous for the continuity of power.

After the short summary of the case studies we can delineate the theses of the dissertation.

1st theses: According to the case studies, the developmental state tries to meet the requirements of globalization, thus it can function further. In the case of Singapore, the adaptation to the always changing needs of world economy occurred properly; therefore the developmental state did not have to go through a crisis-period. In the case of Korea such adaptation occurred only after the Asian financial crisis. The long-needed reforms were introduced only after the weakening of the interest-groups.

The developmental state adapts to the requirements of globalization, therefore, it cannot function anymore.

2nd thesis: In the case of the developmental state that adapted to the needs of globalization, FDI attraction has a crucial role. In the case of Singapore FDI attraction was, from the beginning, one of the most important elements of industry policy. It was introduced through the modernization of industry structure, FDI attraction (that represented a higher added value), and the elimination of the sectors that still used old technologies. In Korea the supporting of FDI attraction was mainly due to the Asian financial crisis. During the crisis big corporations welcomed significant FDI inflow, but after the structural reforms they financed their investments through international monetary markets; therefore, the state’s industrial policy was directed towards SMEs. Thus, FDI attraction affects primarily the new,
innovative sectors. That is, in the case of industrialization based on FDI, the negotiating position of local interest groups cannot be raised, and, as a result, industrial structures can be transformed quickly, and regular adaptation to the global economy’s challenges might be carried out.

**FDI attraction is essential for the developmental state’s adaptation to globalization.**

3**\textsuperscript{rd} thesis:** In order to achieve FDI attraction, the developmental state, besides the special, micro-level stimulators, puts emphasis on the development of business environments. This is illustrated by the improvement of WGI (Worldwide Governance Indicators), indicators designed by the World Bank to measure governance performance. In the case of Singapore, WGI indicators show us the excellent government performance. A performance lower than the average can be detected only in the participations in political processes, and in the government’s accountability. In the case of Korea data are less impressive, but it is clear that the government is dedicated to a developmental policy that is able to survive in globalization. WGI indicators show us a tendency towards improvement. One can observe improvement in the quality of regulations, and in the efficiency of the law system and governance.

**Because of the importance of FDI attraction, the improvement of governing skills is a task of utmost importance.**

4**\textsuperscript{th} thesis:** The developmental state can bring about quick economic development even in the context of globalization. Because people were used to the quick development in the first decades of the developmental state, they always demand economic development. But, as WGI indicators show, besides the economic development based on FDI attraction the development of democratic processes is lagging behind.

**The developmental state’s legitimacy in globalization is created by economic growth, and, as a consequence, the limitations of democracy become socially accepted.**
Summing it up: The developmental state does not disappear in globalization, it gets adapted to globalization. It has as its continuous task to ensure economic growth, and, as a result, society accepts the state’s interventions and the limitations of democratic processes. Instead of immediate market coordination, FDI attraction became the most important tool of industry policy.

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For the Central-European industries the experiences of the Asian developmental states are important from the perspective of exploiting the opportunities inherent in globalization. Asian experiences draw attention to the importance of a strong state and strong institutional system in the global competition for success. They offer methodologies regarding the strengthening of the state’s negotiating position, and, thus, the possibilities of globalization in a way that national interests may not suffer.
IX. Bibliography


List of publications related to the dissertation

Article(s), studies (4)

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