The State in the Context of an Internationalizing Production System: From Myth to Reality

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Abstract
Only in East Asian do we find nations that have experienced rapid economic development during the neoliberal era. These nations have consciously rejected virtually all the dictates of neoliberalism, particularly in terms of the open acceptance of TNCs. They have utilized a Developmental State to construct dense, highly intensive and dynamic production systems. When hosting TNCs they have been neither passive nor pliant, demanding reciprocity in terms of technology spin-offs, training, and linkage effects-thereby interrupting the closed circles of intra-firm supplier relationships. A large body of empirical work demonstrates that the neoliberal attempt to demonize the State, particularly the State in the ISI stage, is largely without empirical validity. When states consciously strive for greater income equality, while they seek an active ISI policy, their performance is enhanced. Far from forcing the State to wither away, the new era of thin globalization demands a renewed era of state intervention, including the need to persist in the creation of parastate firms and to forestall or reverse instances of privatization.

Resumen

Podemos ver, pero solamente en los paises de Asia Oriente, un proceso de creciemiento rapido durante la epoca del neoliberalismo. No es coincidente que estos paises han rechazado los dictamines del neoliberalismo, sobre todo en terminos de sus relaciones con las empresas transnacionales. Han utilizado la politica del Estado Desarrollista para construir una red densa, intensivo y dinamico en apoyo de sus sistemas de produccion nacional. Cuando se aceptan empresas transnacionales en su territorio esta bajo condiciones de reciprocidad para capturar los beneficios de la tecnología, el entrenamiento y los vinculos entre los abastadores nacionales y las transnacionales. Tambien juega un papel importante la imposición de una politica de incrementar el grado de igualdad de ingresos y mantener vigorosamente una politica de substitutcion de importaciones.

The Demonization of the State

Over the past two decades we have witnessed a complex double movement consisting of the sanctification of the inevitability of "globalization" and simultaneously the demonization of the State. As to the State-particularly in developing nations-it is asserted with great solemnity that passive and pliant States can foster development, but only to the degree that they restrict their activities to the provision of institutional support for a market economy. Such institutional support is generally defined in terms of a general opening to direct foreign investment (DFI), privatization of all parastate firms, the imposition of a "flexible" labor market which will constrain/eliminate union power, an open trade policy without capital account restrictions, "getting prices right"-eliminating all subsidized social programs-the virtual end of all policies designed to limit the growing disparity of income and wealth, and the end of all Keynesian fiscal and monetary policies that would provide for full employment policies. The Minimalist State, according to the now in vogue neoliberal perspective, is the only conceivable and legitimate state form if nations seek to develop.

All of the above is commonly subsumed under the term "the Washington Consensus"-which, thankfully, is now dying, if not dead (Cypher 1998; Gore 2000; Stiglitz 2001). Many events have undermined the Washington Consensus-most notably the Asian Crisis of 1997, the Russian crisis of 1998, the bursting of the Wall Street speculative bubble in 2000, and the collapse of the Argentine economy in 2001/2002. Less noted, but equally important, was the recession of 2001-2002 which struck at the heart of the neoliberal policy of "export-at-all-cost" that had undergrid the supposed new "Mexican economic miracle" of the late 1990s (Cypher 2001). (On a per-capita basis no other nation has received the neoliberal influence and financial support lavished on the Mexican government by the IMF the World Bank [WB], the Interamerican Bank and the US since 1982.) Half-hearted attempts to dismiss the Asian Crisis as "crony capitalism" and the Russian default as "gangster capitalism" began to wear thin by 2000-by 2002 proponents of neoliberalism/ globalization had lost much of their credibility.

Aggregate data, too, revealed some alarming tendencies which should cause all but the most dogmatic to reflect on their enthusiasm for the Washington Consensus: The UN's The Human Development Report had revealed in 1996 that after decades of development policymaking the global share of income accruing to the bottom 20 percent of the world's population had fallen from 2.3 percent in the mid-1960s to only 1.4 percent in the mid-1990s, while during the same time period the share of the top 20 percent had risen spectacularly-from 70 percent of global income to 85 percent (Yusuf and Stiglitz, 2001, 249). Table I, below, records the dramatic failure of the neoliberal era to deliver on its promises of a growth explosion ("unleashing capitalism") as a result of high IMF 'conditionality' and aggressive Structural Adjustment Programs (SAP) imposed across a broad swath of developing nations in the 1980-1998 period:

Table I: Median Unweighted and Weighted Growth in GDP Per Capita
(percent per year-inflation adjusted real growth)

Unweighted Developed Nations Developing Nations

1960-1979 3.4 2.5

1980-1998 1.8 0.0

Weighted ___ 0.8

Sources: William Easterly, "The Lost Decades: Explaining Developing Countries' Stagnation", 1980-98, typescript, World Bank, January 2000. Branko Milanovic, "True World Income Distribution 1988 and 1993", Policy Research Paper 2244, Development Research Group, World Bank, November 1999.

The "weighted" inclusion calibrates the median rate of growth in counties' per capita GDP growth with regard to population size. Thus, this method shows a higher median growth rate for developing nations (0.8 vs 0.0) due to the relatively strong performance of China and India-nations with populations above one billion. China's per capita growth, at 6.3 percent in the 1988-99 period, and India's, at 4.9 percent, are remarkable exceptions to the two "lost decades" under neoliberal policymaking (World Bank, 2000, 274). What is most remarkable, however, is the fact that neither China nor India are examples of successful applications of neoliberal/neoclassical policymaking. China has continued to utilize a unique combination of central planning and the market, while India has been pressed since 1991 to adopt the Washington Consensus, but has failed to do so. All in all, objective observers-faced with the data in Table I-are forced to question the efficacy of the simple nostrums of neoclassical development theory, and this has opened the way to a new focus.

Import-Substitution Industrialization

Nowhere in the vast body of literature devoted to economic development is it possible to find a better example of the demonization of the State than in the prevailing view that Import-Substitution Industrialization (ISI) was at best a counterproductive policy adopted throughout the developing world in the 1950s, 60s and 70s. Brazil's economic growth in that period owed much if not everything to the policy of (ISI), as Alice Amsden has carefully documented (Amsden 2001). Yet, Werner Baer-the foremost expert on Brazilian development in the US-has recently argued that ISI caused numerous problems, while under neoliberalism "some of these problems have been dealt with more effectively" (Bauer 2001). Many of the "problems" that Bauer cites, such as the concentration of income, have merely become more acute in Brazil and throughout Latin America as nation after nation embraced neoliberalism. Yet the issues, such as the control of inflation, that have been addressed in the neoliberal era are overwhelmingly of second order importance. Of primary importance (except to neoliberals) is the fact employment and real wage growth were steady counterparts of the ISI period for millions of workers in the developing world. Now, throughout Latin America, attaining the 1980 standard of living is less likely than at any time in the past 20 years-with the possible exception of Chile. Yet Bauer is hardly alone, his misrepresentation is repeated over and over, even by careful and generally fair-minded scholars such as the US political scientist
Robert Gilpin (Gilpin 2000, 25). Fortunately, Henry Burton's full-scale rebuttal of the "failure of ISI" myth is readily available (Burton 1998). Unfortunately, many critics of neoliberalism do not seem to have a good account of the historical record, and they have unwittingly served the interests of the neoliberal agenda in their failure to challenge the ideology of the Washington Consensus on this point.

Thick and Thin Globalization

Hyperglobalists whether at the IMF/WB, within the US government, or in power in many developing nations, imagine a teutonic process of "thick" globalization with ""intensive" global interconnectedness (Held, et. al. 1999, 1-28). As described by David Held and his coauthors, "thick" globalization involves high extensity-massive and dense interregional/intercontinental networks and flows, particularly of DFI-and high intensity-agglomeration effects or interconnectedness of production processes at each local site. Under conditions of high extensity and intensity developing nations would receive massive flows of DFI and such DFI would create large scale spin-offs of technology, training and know-how through deep industrial linkage effects. Were this to be the case, then international financial flows, particularly DFI flows, would have sparked a new period of development which would prove sustainable.

As both Cypher and Kopinak have demonstrated, in the case of Mexico-the prototype for neoliberal 'reform' according to proponents-the result has been 'thin' globalization (Cypher 2001; Kopinak 2003). That is, the result of two decades of neoliberal policymaking has been to create a 'disarticulated' economy in Mexico with transnational corporations (TNCs) operating largely through a dense web of intra-industry transfers while excluding Mexican-owned firms from technology transfers and production opportunities. This process has been particularly acute in the maquiladora industry. The result has been extreme polarization of income, increasing incidences of poverty, international emigration and social decomposition. If neoliberals policies exhibit only an ineffective combination of high extensity/low intensity then globalization is 'thin' and the results found in Mexico are to be expected. They are not a 'failure' to properly 'apply' the principles of neoliberalism-Mexico has been turned into a laboratory for neoliberal experiments-they are a failure of neoliberalism pure and simple.

The Issue of Linkages

The research literature dealing with transnational corporations (TNCs) and Direct Foreign Investment (DFI) is extensive. DFI is viewed as a means of rapid economic development because it provides two crucial missing elements for developing nations (1) capital investment and (2) embodied technological change. It is commonly argued that a low capital/labor (K/L) ratio constitutes the core developmental problem in most nations. While some variants of modern research have veered from this conceptualization to emphasize 'social capital' and several other variables, it is nonetheless argued that the chronic low productivity in developing nations is largely a function of a low national savings rate and an insufficient array of machinery and equipment available per worker. Moreover, since technological change is embodied in new capital equipment, nations that receive large infusions of DFI will also likely be able to skip a complex process of technological evolution and leap into the upper levels of modernized production processes employing a full range of cutting edge Information Technologies (IT). All this, however, depends on the establishment of pervasive linkages between the TNCs and the domestic producers. The TNCs, in theory, could be important incubators of technological spin-offs-particularly if they employ managers and engineers who then create independent start-up companies that can operate with modern technologies. Yet, the question remains: Are these imagined effects to be realized?

The answer, well-documented in the UNCTAD's World Investment Report, 2001 and in UNCTAD's Trade and Development Report, 2002 is (a) not necessarily and (b) rarely (UNCTAD 2001: UNCTAD 2002). While Taiwan Singapore and Korea (discussed in the following section) have had some strong success in high-end knowledge-intensive activities relating to global production

such success stories appear to be exceptions. Generally, developing countries participating in international production chains are not involved in the skill-and-technology intensive part of the overall production process. Where the local suppliers' base is developed, it is mainly the foreign-owned suppliers, rather than national firms, that manufacture the most sophisticated components. This can hinder development of domestic supply capability and carries the risk of the host country getting locked into its current structure of comparative advantage…thereby delaying the exploitation of potential comparative advantage in higher-tech stages of production (UNCTAD 2002, 75). UNCTAD's research reveals weak and inadequate levels of backward linkages to domestic supply chains in most of Asia, and particularly in Latin America, while the production processes controlled by the developing nation generally is limited to low value-added assembly and other labor intensive processes such as packaging and janitorial services(UNCTAD 2002, 71;75) The only exception to these findings pertains to the East Asian production systems. Developing nations, following the export-at-all-costs urgings of the neoliberals, have dramatically restructured their export sectors-In 1980 the share of primary exports in total exports was 51%, while in 1998 it was a mere 19% (UNCTAD 2002, 68) Labor-intensive resource-based manufacturing continued to account for slightly over 20% of exports in both years, while medium and high-skilled manufacturing processes rose as a share of exports from 20% in 1980 to 48% (UNCTAD 2002, 68). Yet, aside from East Asia these data portray a false image of the structural shifts occurring in the neoliberal era since the shift to higher levels of manufacturing is largely a function of strategies and processes totally controlled by 'resource-seeking' TNCs searching for cheap, pliant labor-an outstanding case study of this phenomenon is the Mexican auto sector which has largely become a mere extension of the Detroit corridor (Cypher 2001) As UNCTAD states:

Statistics showing a considerable expansion of technology and skill-intensive exports from developing countries are misleading. Much of the skills in these exports are embodied in components produced in the technologically more advanced countries, while developing countries are engaged mainly in the low-skill, low-value added assembly stages of global production chains generally organized by the TNCs. Thus expansion of such exports has not been accompanied by concomitant increases in value added and in income earned in developing countries (UNCTA 2002, 53).

The Developmental State

Well beyond the theoretical and epistemological parameters of the neoliberals at the IMF/WB lies a body of well-documented research demonstrating the need for a set of institutions which are not merely "market enhancing". From the perspective of Developmental State theory the need for a set of institution which guarantees functional collective action is not merely a coequal to the need for well-functioning markets in the pursuit of economic development. Using a framework which Raul Prebisch would have found highly relevant, advocates of the Developmental State argue that the state must be both a locus for a broad array of institutions and a means to directly spark and redirect the accumulation process. The relation between state and capital is not one of equality-the state has to have the means to discipline capital, and the capability of functioning entrepreneurially as a 'first mover' inaugurating new industries and sectors. Regarding a developing nation's policies toward openness, the state cannot accept static comparative advantage-it must be able to recreate comparative advantages as a nation climbs through stages of technological development. Here technology is viewed as an 'institution' in that nations must pursue a technological policy-one that eventually leads them to technological autonomy. At its core, a Developmental State must have the capacity for leadership vis-à-vis its relationship with capital-a juxtaposition which only can arise when the state has a highly trained, 'exceptional' bureaucracy at its command, and the means to guarantee compliance from capital in return for state-supported assistance, or preference, which has been proffered to foster national development.

Peter Evans' research in this area is perhaps the most detailed. His term embedded autonomy attempts to evoke an institutional structure wherein the state is embedded in social relations with the private sector-relations are 'close' through joint management schemes, perhaps, or through meetings, panels, commissions, etc., which allow for a deep understanding by the relevant state bureaus of the needs and capabilities of the private sector. While a relationship of trust and mutual communication is essential, so equally, is autonomy-state bureaus, in their (1) promotion, (2) oversight and (3) regulation capacity cannot become captured by the private sector. For advocates of the Development State theory it is the muscular, independent, entrepreneurial state to be found in particularly in Japan, Korea and Taiwan which opens the door to the possibility of rapid and sustained economic development. Yet, the state cannot demand mere 'followership' from the private sector. The state needs to foster conditions whereby a "highly capable, coherent business community" is created and sustained (Evans, 1998, 69).

The creation of a functioning bureaucracy leading and guiding the accumulation process does not necessitate the eradication of all mediocrity, mendacity and clientelism but rather is conditioned upon the insulation of key economic bureaus-this is the lesson of Asia's success, and it is transferable.

Alice Amsden makes a resounding case for manufacturing as the core activity giving rise to development (Amsden, 2001). The successful incorporation of the manufacturing sector is viewed, above all, as arising from new institutions put into motion through astute government development policies which hinge on the creation of a new control mechanism between government and the private sector-the principle of reciprocity.

Reciprocity is the link between government support and industrial performance. Development banks, in particular, used reciprocity to break the hold of family-based managerial cadres in top firms, insisting that support (tariffs, duty-free intermediate inputs, etc.) will occur only if qualified professionals are in control of firms. Nations "sneak ahead" if they rely on developmental banking (which imposes control mechanism to overcome governmental failure), local content management (forcing producers to sequentially rely on greater local content), selective exclusion (keeping some domestic markets closed to foreign firms/trade) and national firm formation (creating strong national firms with growing knowledge-based production capabilities). In this context sneaking ahead involves avoidance of the doctrines of the IMF and the World Bank regarding Direct Foreign Investment-DFI lags rather than leads waves of expansion of domestic investment. The foundational basis of capital formation and technological deepening comes in the first instance from public sector investment, and not from DFI.

Amsden's work is perhaps the most detailed effort yet to focus on the role of manufacturing in the process of development: Her study centers on "the rest"-those developing nations that did not fall behind the advanced nations in the last half-century. Included here are China, India, Indonesia, So. Korea, Malaysia, Taiwan, Thailand, Argentina, Brazil, Chile, Mexico and Turkey. These nations produced 4.9 percent of world manufacturing in 1965, and 17.4 percent of it in 1995 (Amsden 2001, 2). They stood in stark contrast to other 'developing" nations because:

… countries without robust manufacturing experience tended to fall further behind, and the developing world became divided between those that were excluded from modern world industry and those that were redefining its terms. (Amsden 2001, 1-2)

Amsden argues that the basic problem of development is "too few knowledge-based assets" not too little infrastructure or education. Knowledge is conceptual, firm-specific and proprietary, and most intensely created, utilized and supported through the growth of a manufacturing sector-"the heart of modern economic growth." (Amsden 2001, 3). The technological capabilities most instrumental in fostering the acquisition and development of this crucial component of the development process are: (1) production capabilities, (2) project execution capabilities, and (3) innovation capabilities.

Moving from a predominantly agricultural, backward, nation suffering from a shortage of skills to membership in "the rest" required nations to adopt an Industrial Policy centering on the principle of reciprocity-the state created a new institutional structure designed to minimize both market failure and government failure. Predominantly, this was achieved through the shrewd utilization of "development banks" such as Mexico' Nacional Financiera and Brazil's BNDES, or through other means, such as entry restrictions on foreign capital, tariff protection, subsidized credit, duty exemptions for machinery imports, and so on. As important as they have proven to have been, the development banks were only part of much larger ISI policies. ISI-when it worked-which was very often-demanded in exchange for some favorable treatment in specific industrial sectors that these sectors would achieve specific performance standards such as the achievement of an efficient scale of production or the employment of non-familial professionals in top positions in key firms. While acknowledging that corruption was commonly present to some degree, Amsden insists that when ISI meant a dense network of rules and reciprocity requirements the stimulus provided through ISI was in fact complimented by rapid sectoral growth, often bringing positive externalities and virtuous circles into play, as well.

'The rest' rose in conjunction with 'getting the control mechanism right' rather than by getting the prices 'right'. Over a century of sluggish development was reversed and unprecedented manufacturing ensued. Growth rates of manufacturing output per capita grew faster for decades outside the North Atlantic than inside it. (Amsden, 2001 11-12)

Different nations met the challenge of constructing their ISI policies in many varying ways. Amsden makes a convenient distinction between those "integrationists" who failed to create "nationalist innovation systems to champion 'national leaders' with their own proprietary knowledge-based skills." (Amsden 2001 14) Those who failed to achieve this threshold Amsden refers to as the "integrationists" and their fate has been to fall into a subordinate position vis-à-vis foreign capital, with Mexico after 1980 proving to be the best example. Meanwhile, the "independents", such as Korea and Taiwan have forged strong manufacturing capabilities due to the ability of nationally-owned firms to achieve first mover advantages and economies of scale. Building manufacturing ability involves the creation of a cadre of experienced, qualified engineers and mangers and this occurs only through a complex process of institutional evolution: "…manufacturing experience is not simply a stock of knowledge. It is a stock of knowledge that passes through a specific historical and institutional filter." (Amsden 2001 15-16)
National leaders in manufacturing arise more commonly in nations that had a relatively solid background in manufacturing prior to WW II and were able to break-free of the hold of foreign firms over the manufacturing sector.

As central as manufacturing is to the development process, Amsden nonetheless emphasized the need for a relatively high level of income equality-a characteristic which distinguished most Asian economies from other regions, particularly Latin America. In nations with highly unequal distributions of land a power bloc forms to thwart industrialization because landowners achieve Ricardian rents form land. Through their receipt of such rents the rate of return to agriculture remains high which then slows or forestalls the shift to manufacturing because of the relatively lower rate of return. Consequently, if income inequality is associated with a highly unequal land tenure system a nation's 'core competency' will remain in agriculture-this sector will exhibit 'absorptive capacities' which curb a necessary process of institutional evolution as the inheritors of landed estates cling to their landholding pattern of life. Amsden's findings demonstrate that nations which are experiencing relatively greater degrees of income equality are also those able to concentrate their efforts on national leader firms and the acquisition of production skills (Amsden 2001, 191)

If nations can sidestep the trap of agricultural dominance and proceed to build national leader firms, such firms will proceed to create cutting-edge skills along with proprietary control over such skills. A major stumbling block for those who have pursued manufacturing as the avenue to development occurs when nations grapple with the complexities of acquiring technological proficiency. This can occur when a nation manages through state intervention to both increase the level of technical education and education in general and provide through targeted subsidized credit the means for national firms to acquire modern production equipment. A new elite of managers and engineers who exhibit production know-how, are able to execute production projects if they are able to work with an educated, skill-based, labor force. Solving the dilemma of development demands the 'visible hand' of the state, which would accord well with Karl Polayni's perspective regarding the process of institutional transformation:

The developmental state was predicated on performing four functions: developmental banking; local-content management; 'selective exclusion' (opening some markets to foreign transactions and keeping other closed); and national firm formation. As a consequence of these functions, 'the rest' finally made the requisite three pronged investment to enter basic industry-in large scale plants, in hierarchical managements-cum technological skills, and in distribution and marketing networks. Two principles guided developmentalism: to make manufacturing profitable enough to attract private enterprise through the allocation of …(subsidies) and to induce such enterprises to be results-oriented and to redistribute their monopoly profits to the population at large. (Amsden 2001, 125)

Of all of the instruments that the state can utilize, the most efficient is that of development banking in Amsden's view, because of these banks abilities to encourage and to achieve key policy goals such as export expansion, local-content targets in production and price stability. Above all, developmental banks, and the state in general, must impose adequate 'performance standards' as a counterpart to the assistance provided-the most important of which would be large expenditures on research and development (Amsden 2001, 206). Amsden shows that for developing nations virtually every case of successfully rising manufacturing exports has been due to ISI policies. Successful nations have been selectively strategically seclusive rather than merely 'open'-as the World Bank recommends.

Another requisite element, in direct opposition to the views of the World Bank, is the distancing a nation must achieve from TNCs. As bearers of DFI, TNCs are commonly viewed in the development literature as constituent elements of any positive program for development. However, Amsden shows that a partial correlation analysis demonstrates that DFI is negatively correlated with a nation's ability to produce research and development, patents, scientific publications and scientists and engineers engaged in research and development. Furthermore, the sooner a nation accepts the entry of TNCs the less likely a nation will develop the national independence needed to create strong national leaders (Amsden 2001, 208-212) Nations which encourage or do not consciously discourage TNCs from acquiring local firms through majority ownership mergers are also nations with low research and development levels. Thus, screening out TNCs from all but limited sectors of a nation's economy seems to be the best policy for national success.

Far from the dictates of the World Bank that firms develop within the context of the private sector, Amsden research demonstrates that state-owned firms frequently became national leaders crowding-in other private firms due to their positive externality impacts. Other positive externalities included aggregate increases in research and development (through research institutes) which could be appropriated by national firms and the incubation of entrepreneurial capabilities which could be spun off into the wider economy.

It is an axiom propounded by the IMF/WB that developmentalism, or ISI, founders of necessity due to distortions of market forces which generally lead to 'government failures' much more profound than the market failures that ISI sought to remediate. But, based on her extensive study of numerous concrete cases Amsden affirms that:

'government failures' can no longer be taken for granted if governments do use institutional mechanisms to raise productivity and jump start industrial growth. Government failures may be inevitable in the absence of systematic machinery to prevent them, but not necessarily in the presence of such machinery…. The reciprocal control mechanism of 'the rest' was hardly perfect. But it illustrates the possibilities of minimizing government failures even in economies plagued by 'moral hazard' and corruption but enjoying manufacturing experience.

There has not thus far been widespread recognition of the systematic machinery that countries in 'the rest' put in place, implemented and monitored to avoid government failure and to pursue developmental goals. Yet 'getting the control mechanism right' whether or not prevailing prices were 'right' was central to the postwar process of catching up. (Amsden 2001, 290)

Conclusions:

Only in East Asian do we find nations that have experienced rapid economic development during the neoliberal era. These nations have consciously rejected virtually all the dictates of neoliberalism, particularly in terms of the open acceptance of TNCs. They have utilized a Developmental State to construct dense, highly intensive and dynamic production systems. When hosting TNCs they have been neither passive nor pliant, demanding reciprocity in terms of technology spin-offs, training, and linkage effects-thereby interrupting the closed circles of intra-firm supplier relationships. A large body of empirical work demonstrates that the neoliberal attempt to demonize the State, particularly the State in the ISI stage is largely without empirical validity. When states consciously strive for greater income equality, while they seek an active ISI policy, their performance is enhanced. Far from forcing the State to wither away, the new era of thin globalization demands a renewed era of state intervention, including the need to persist in the creation of parastate firms and to forestall or reverse instances of privatization.

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