

## Economic Development

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What is the first thing that comes to mind when you think of economic underdevelopment? Southern Californians probably have a better understanding of the term than many other Americans. California, one of the richest states in the United States, shares a border with the poor Mexican state of Baja California. Many Californians have had the unforgettable experience of crossing the U.S.–Mexico border at San Diego, arriving in the Mexican city of Tijuana, which essentially takes the traveler from an orderly and prosperous urban area to a much poorer one—a striking contrast for people on both sides of the border. At the same time, thousands of Mexicans can be seen crossing the border from Tijuana to San Diego, drawn by the substantially higher wages that even low-level jobs in the United States can provide. Miles of corrugated iron fencing stretch along the Southern California border to prevent job-seeking Mexicans from crossing illegally.

The contrast between San Diego and Tijuana is merely one highly visible example of the gap between the rich and poor countries of the world. While people who live in the wealthy countries tend to take their comfortable lifestyles for granted, more than four-fifths of the world's population lives in less developed (or “developing”) countries, including both medium- and low-income countries. The United States, in contrast, belongs to a select group of wealthy, or “developed,” countries known for high standards of living and overall well-being.

Not all people who live in poor countries are poor—and not all people who live in rich countries are rich. However, the vast majority of the world's poor live in developing countries, and the degree of poverty in these nations

is much more extreme than that in developed countries. First-time visitors to developing countries from wealthy countries such as the United States may be shocked, for example, to see large communities of hand-built shanties, or school-age children working as street vendors to help support their families. In 2010, nearly a quarter of the children in the developing world were underweight; nearly a billion people were undernourished; more than 2.6 billion people lacked access to basic sanitary facilities, such as flush toilets; and one in five workers and their families were living in extreme poverty, defined as living on \$1.25 per day or less. Almost all the people behind these statistics of suffering were living in developing countries (United Nations 2011:8–14; United Nations Food and Agriculture Organization 2010).

Why are some countries rich and other countries poor? What is the best way for poor countries to better the lives of their people? These are the central questions in the study of economic development (also referred to simply as development). Starting about 30 years ago, debates about **development** began to be dominated by economists advocating reliance on free market forces. The governments of poor countries around the world received regular visits from economists working for international organizations who gave them detailed advice about how to improve their economies. The economists working within their own governments gave them similar advice, which could be summarized as follows: Grow the economy by freeing markets. More recently, however, economists' advice to developing countries has become more diverse and more open to considering the nonmarket foundations of development. This chapter is divided into three sections. The first examines how economic development should be defined. The second section looks at some of the advice that economists have given to developing countries since the founding of their discipline—and the ways that governments have followed and ignored that advice. Finally, the third section looks at sociological contributions to development debates.

## Economic Development Defined

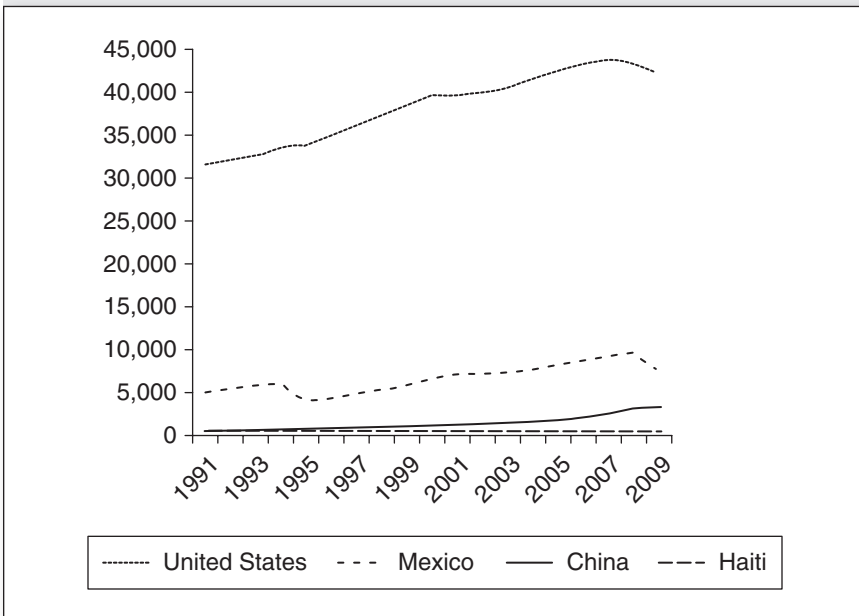
If you have traveled back and forth between the developed and the developing world, you have an intuitive understanding of what economic development means—you know it when you see it. In reality, however, the meaning of economic development is more difficult to pin down than it appears. Development, the process of improving people's lives over time, is a fundamentally *relative* concept, in the sense that what counts as “developed” changes over time. One of the problems of underdeveloped countries is that they have no fixed point of development to catch up to: As countries such as the United States

continue to grow and become more technologically sophisticated, countries such as Mexico are in danger of falling increasingly far behind.

Development is also a *complex* and *contested* concept, in the sense that there are different views about the best way to define and measure it. A half century ago, development experts agreed that development was best defined by national income per capita—that is, the total value of the goods and services produced by a nation over a period of time divided by the number of people. This is no longer the case, for reasons we will examine shortly. Nevertheless, national income—measured in various particular ways, including gross national income (GNI) and gross domestic product (GDP)—continues to be a widely used measure of how wealthy a country is, overall, and so we will briefly discuss it here.

Exhibit 7.1 illustrates changes in the GDPs of the United States, Mexico, Haiti, and China since 1990 (controlled for inflation to take into account the decreasing value of money over time). There are a number of interesting things to note in this graph. One is the enormous discrepancy in wealth if we compare the United States, a developed country, and the three developing countries of China, Haiti, and Mexico. Even Mexico, a middle-income

**Exhibit 7.1** GDP per Capita in Four Countries (in 2005 U.S. dollars)



Sources: St. Louis Federal Reserve (2011) and World Bank (2011).

country, has a per capita GDP that is dwarfed by that of the United States—and the gap has recently been growing. The exhibit also shows that the recession that began in 2008 decreased the size of the economy per person in both Mexico and the United States.

One of the most striking things to notice is what has been happening to the two poorest countries on the graph, China and Haiti. Both countries started out (see the left-hand side of the graph) with very low per capita GDPs; in fact in 1991, China's per capita GDP was actually *lower* than Haiti's. Since then, however, the two countries' national incomes have diverged. Haiti has remained a very poor country, with a GDP per capita of less than \$700 per person—about the same as in 1991. In contrast, China's real GDP per capita grew to be more than eight times bigger between 1991 and 2009. China's economy per person is nowhere close to that of the United States, or even of Mexico. However, it is increasing at a phenomenally rapid rate; in other words, China's economy is growing fast. This is one of the reasons China is so widely regarded as a development success—an issue to which we will return later in this chapter.

National income per capita is an important statistic because it gives us a sense of the resources available in a country to buy things that people need, or that make their lives better—from the food they eat to the medicine they take to cure their diseases to the petroleum they use to get where they need to go. Consider that in Haiti, the economy produces only \$700 worth of goods and services per person per year—not enough for people to live at a decent standard of living, even if economic resources were distributed absolutely equally. However, national income also has some important limitations, which is why in recent decades development experts have been looking at alternative ways of measuring and conceptualizing economic development. One limitation is that it does not take into account the fact that a dollar will buy more in Haiti or China, say, than it will in the United States. This is why development experts increasingly use “purchasing power parity” (PPP) measures of national income, which control for differences in prices.

A second problem with focusing on national income per capita is that it takes into account only economic activities that occur in the market economy, leaving important nonmarket economic activities (most notably housework and child care in the home) unmeasured. A third, related problem is that national income does not take into account the larger social and environmental costs or “externalities” that may be generated by some forms of market activity. If a developing country chooses to raise its GDP per capita and destroys its natural environment at the same time, the costs to future generations—and to the world overall—are substantial, but these costs are not deducted from the GDP statistic. In general, growth in national income

leads to more intensive use of natural resources and higher levels of carbon emissions, which are associated with climate change. Since it would be impossible for the planet to sustain a worldwide population of people consuming as much and emitting as much carbon as, say, the typical U.S. citizen, development experts have been searching for alternative, more sustainable development models (see Broad and Cavanagh 2009; United Nations 2010:18–19).

Finally, a problem with using national income as a measure of development is that it is an imperfect measure of overall human well-being—the ultimate goal of economic development. This is apparent if we look at more direct measures of how well-off people are, such as life expectancy, literacy, or happiness. For example, take infant mortality—a measure of how many babies die before their fifth birthdays out of every 1,000 live births. In poor countries overall, many more young children die—usually of preventable illnesses, such as respiratory infections and diarrhea—than in wealthy countries overall. But among countries with the same GDP there is considerable variation in infant mortality. The United States is the wealthiest country, in terms of per capita GDP, among the countries shown in Exhibit 7.2, but it is not the one with the lowest infant mortality. Malaysia—a country six times poorer than the United States in terms of GDP per capita—has a slightly lower level

**Exhibit 7.2** Infant Mortality and GDP per Capita, Selected Countries, 2009

<i>Country</i>	<i>Infant Mortality</i>	<i>GDP per Capita</i>
Japan	2.4	\$39,738
France	3.2	\$41,051
Malaysia	5.7	\$7,030
United States	6.8	\$45,989
Costa Rica	9.6	\$6,386
Mexico	14.7	\$8,143
China	16.6	\$3,744
Haiti	63.7	\$646
Nigeria	85.8	\$1,118

*Source:* World Bank (2011).

of infant mortality. Similarly, Nigeria is nearly twice as wealthy as Haiti, but it has considerably higher infant mortality. If we were to examine measures of literacy, life expectancy, or life satisfaction, we would find many similar discrepancies between national income and human well-being.

How can we explain why countries with similar national incomes can be so different in terms of how well their citizens live? There are many reasons, but two important ones are economic inequality and social welfare policy. Two countries with the same national income per capita may differ in how much socioeconomic inequality they have; too much difference between the haves and the have-nots is bad for human well-being, particularly in very poor countries where resources are scarce. Gender inequality, too, can vary in ways that lead to differences in social welfare. Women around the world are poorer than men, on average, and tend to have less education, poorer health, and more restrictions on their personal freedoms. The oppression and deprivation of females is bad for their societies more generally, as it means that half the population is failing to achieve its full potential. Moreover, studies have shown that the children of uneducated women, both male and female, are more likely to die before reaching their fifth birthdays and are also more likely to suffer from malnutrition (Todaro and Smith 2009:58, 382–85). Countries with the same national income per person may also differ in how much their governments prioritize policies for promoting social welfare. Government programs that give the poor access to education, health care and vaccinations, and clean drinking water can improve well-being tremendously.

Because national income is an important but imperfect measure of human well-being, development economists today use it in conjunction with other, more direct measures, such as infant mortality. For more than 20 years, the United Nations has published a “human development index” (HDI) that enables comparisons among countries through an aggregate measure that includes life expectancy, educational attainment, and national income per capita. Significantly, during the period that China was experiencing rapid growth in national income, as illustrated in Exhibit 7.1, it was also improving its HDI overall—in other words, China looks like a development success even if we look at multiple measures (United Nations 2010:3, 27).

We have seen that development has become a much more complex concept than it was a half century ago. As one recent book on development aid puts it, when defining development today,

most policymakers and practitioners would probably emphasize three things: increases in per capita incomes that lead to a sustained reduction in poverty; an expansion in the physical infrastructure and public services (such as education and health) that are both the means and ends of social and economic

progress; and increasingly capable and effective governments that provide for security, the rule of law, responsible economic management, social inclusion, and political freedoms that are also means as well as the ends to improving the human condition. (Lancaster and Van Dusen 2005:5)

With such a complex and tentative definition, there is a great deal of room for disagreement among development experts about what development is exactly, and what is the best way to measure it.

Although development scholars may disagree about how to define development, the most interesting debates today are about what makes development *happen*. What has been the key to the success of countries such as the United States and Japan—or, more recently, China? And what should a country such as Mexico or Haiti do to become richer and provide a better standard of living for its people? In the following section we look at what classical economists had to say about this issue—and at what developing countries actually did.

## **From *The Wealth of Nations* to the Washington Consensus**

How do poor countries become rich? This question was what inspired Adam Smith, the founding father of modern economics, to write *The Wealth of Nations* in the late 1700s. Classical economists such as Smith, and later David Ricardo, became famous for promoting the idea that leaving markets alone would lead to economic prosperity.

Economic development in Europe did not occur simultaneously in all countries; rather, it was uneven and advanced faster in some countries than in others. By the time of Smith and Ricardo, England was ahead of its neighbors in many respects, thanks to an industrial revolution that was making mass-produced goods available for popular consumption, turning peasants into workers, and making some capitalists enormously wealthy.

As less developed European nations struggled to catch up to their neighbors, and more developed ones fought to maintain their advantage, a political economic system known as mercantilism emerged. The idea behind mercantilism was to protect domestic industry from foreign competition by imposing **tariffs** (taxes on imports) and other barriers to inhibit the sale of foreign products at home. Mercantilism also gave the firms of a given country a monopoly on the sale of goods to the colonies of that country—an enormous boon to these firms at a time when colonies were extremely important. For example, only British firms were allowed to sell goods in the 13 American colonies, whereas the French colony of

Saint-Domingue (later Haiti) was exclusively serviced by French merchants. The mercantilist system was a form of what is more commonly known today as **protectionism**—the protection of domestic producers from foreign competition through tariffs and other import barriers.

Adam Smith was both a critic of mercantilism and a keen observer of the emerging capitalist system. Although much of what he says in his masterwork *The Wealth of Nations* ([1776] 1900) seems quite matter-of-fact today, it seemed revolutionary at the time it was written. This was because Europe was emerging from a system of social relations based on tradition and religious faith rather than free markets. Many wondered if the marketplace, lacking the guidance of tradition to ensure proper behavior, would be anarchic, with people stealing and murdering in pursuit of their own individual gain.

Smith's contribution to this debate was his contention that the marketplace would not degenerate into anarchy and chaos but, rather, could help make everybody better-off by harnessing the power of individual greed. This assumed that governments would provide law and order and protect property rights. In the marketplace, each selfishly motivated individual is confronted by a host of similarly motivated individuals; as a result, each actor is forced to meet the prices offered by competitors. Among the beneficial effects of competitive markets are lower prices to consumers, the elimination of the production of unwanted goods and the expanded production of wanted ones, and incentives for technical innovation to lower production costs. In such a system, the investor is "led by an invisible hand to promote an end which was no part of his intention. . . . By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it" (Smith [1776] 1900:345).

Smith also observed that the power of the invisible hand is often stymied by the sometimes well-intended efforts of people to create desirable moral outcomes through government intervention. The artificial fixing of food prices to help protect consumers, for example, often has the unintended effect of creating food shortages (and black markets), because farmers refuse to sell their goods at the low official prices. The mercantilist system made a few traders extremely wealthy but impoverished thousands of consumers who had no choice but to purchase the overpriced products sold by the merchants of a single nation. In a system in which every nation tries to "beggars its neighbor" through restrictions on imports from other nations, Smith believed, all nations become worse off.

Smith's critique of mercantilism was taken up further and systematized by David Ricardo, an English economist born around the time of the publication of *The Wealth of Nations*. Ricardo's theory of "comparative advantage" is now standard fare in any introductory economics course. In brief, it



shows how every country is better-off specializing in whatever it produces most efficiently and exchanging goods in a system of free international trade. For example, Washington State has a cool climate congenial for growing apples, whereas Florida is a hot state where oranges flourish. Great greenhouses could be built to sustain an orange industry in Washington State; conversely, air-conditioned indoor orchards could be used to grow apples in Florida. To make these domestically grown fruits competitive, the governments of Washington and Florida could charge high tariffs on imported fruit. But would this really make the inhabitants of Washington and Florida better-off? The idea of comparative advantage is simply that it is much more efficient for Florida to specialize in oranges, for Washington to specialize in apples, and for each to trade freely with the other.

Although neither Smith nor Ricardo wrote specifically about the issue of economic development (the term had not been coined yet), the implications of their writings for less developed countries were immediately apparent. In the late 18th century, England was a leader in the production of industrial goods. Other countries, such as the newly independent United States of America, had little industry and specialized in the export of raw materials such as cotton and timber. The classical economists' recommendations for an underdeveloped country such as the United States were that it should continue to specialize in the export of raw materials and continue to import industrial products from England. This recommendation was, of course, very much in the national interest of England, which wanted to continue to sell its industrial products in America and which urged the new government of the United States to engage in practices of free trade.

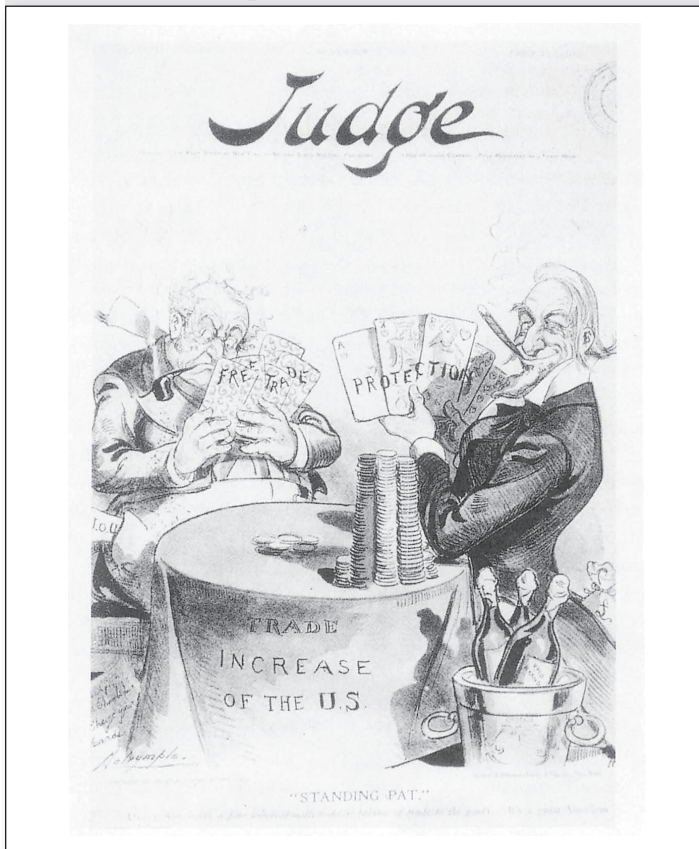
## Smith and Ricardo Ignored

Did the leaders of the newly independent United States see the wisdom of the classical economists' advice and follow it? Not consistently. Alexander Hamilton, one of the Founding Fathers, thought that it was a bad strategy for the United States to continue in this economic role and that the only way to ensure prosperity for the emerging United States was to protect domestic manufacturers from foreign competition (Hamilton [1791] 1966). Abraham Lincoln also supported protectionism, adhering to the view that "the abandonment of the protective policy . . . must result in the increase of both useless labour, and idleness, and so, in pro[por]tion, must produce want and ruin among our people" (quoted in Eckes 1995:32).

In the United States, protectionism was particularly important in the post-Civil War period, when the United States made the transition from an agrarian to an industrial economy (Krooss 1974:406-7; Levy and

Sampson 1962:236–37). Exhibit 7.3 shows an early 20th-century political cartoon supporting protectionism in the United States. Not until later in the 20th century, when U.S. industries had become internationally competitive, did the U.S. government become an advocate for international free trade. According to Cambridge development economist Ha-Joon Chang (2005), virtually all countries that we consider to be developed today—including the United States, Japan, Germany, and France—had major government interventions in their national economies at the time that they were trying to catch up to more advanced economies. These included not only the protection of domestic industries from

**Exhibit 7.3** “Standing Pat.” Uncle Sam, the Protectionist, Triumphs over John Bull, the Free Trader



Source: *Judge*, November 14, 1903. Special Collections, Alden Library, Ohio University.

foreign competition but also industrial policies (e.g., subsidies and tax incentives to industries deemed to be of national importance) and major government investments in research and the development of new technologies.

During the second half of the 20th century, a new group of countries similarly flouted the classical economists' advice. These nations belonged to what is often called the Third World—a group of poor countries that had once been colonies of European powers and that were now searching for ways to become wealthier and more powerful and to improve the living standards of their people. At that time, the near-universal consensus among the leaders of such diverse countries as Mexico, China, India, Cuba, Egypt, and South Korea was that the invisible hand of the marketplace could not be relied upon to generate sufficient economic development. But if markets were not the answer, what was? Third World nations arrived at two different answers. The first was that these nations needed to use the power of the state to help create the conditions for capitalist industrialization and growth in national income. The idea that capitalist economic development needs be promoted through active government policy is sometimes called **developmentalism**. The second answer was socialism—eliminating private ownership altogether and having the state make all decisions about economic investment and distribution of resources directly.

Developmentalists, such as the economists of the United Nations Economic Commission on Latin America (ECLA), echoed many of the arguments that Alexander Hamilton had made nearly 200 years earlier. In their view, the only way Third World countries could progress was through industrialization—by moving toward production of manufactured goods such as steel, automobiles, and refrigerators. Toward the beginning of the 20th century, Latin American countries specialized in the production and export of primary commodities—raw materials and agricultural products, such as coffee, cotton, minerals, and petroleum—just as the United States had scarcely 100 years before. One of the problems with a commodity such as cotton, argued the ECLA, was that its price was liable to fluctuate greatly on international markets. Even worse, the price of cotton tended to decrease over time. Many underdeveloped countries were producing cotton and attempting to undersell one another on international markets. At the same time, technological advances often replaced products such as cotton with synthetic substitutes (e.g., nylon and polyester). As a result, as the prices of primary commodities such as cotton and bananas went down, underdeveloped countries would have increasingly limited revenues to purchase imported industrial goods.

The specialization of countries such as Mexico and Colombia in primary commodities also had harmful social consequences. Industrial revolutions,

such as those that had already occurred in England and the United States, created manufacturing jobs for people who had formerly worked on the land; people who got jobs as factory workers received paychecks that enabled them to buy industrial products, leading to increased production, in turn leading to more jobs, and so on, in a virtuous cycle. In contrast, the international competitiveness of a primary commodity such as cotton depended either on low wages or on increasing mechanization that put farm laborers out of work; neither option was likely to provide higher wages and a better standard of living for the population. As droves of Latin Americans began to flock to cities from the countryside in search of jobs, the idea of government-sponsored industrialization became extremely compelling.

The solution, according to ECLA economists, was to industrialize Latin American economies by protecting domestic entrepreneurs through tariffs and other barriers to foreign imports. The rationale was that this was the only way to keep new domestic “infant industries” from being driven out of business by foreign imports. For example, a Mexican entrepreneur starting a bicycle factory faced overwhelming disadvantages with respect to Schwinn and other bicycle manufacturers located in the United States. Not only did Schwinn have the advantage of decades of experience in the industry, and immediate access to raw and intermediate materials that came with being located in an industrialized country, but Schwinn also had easy access to the U.S. capital market. In the short term, protecting Mexican bicycle manufacturers would harm Mexican consumers, since it made bicycles more expensive, but in the long term it would help Mexican citizens by setting Mexico on the path to industrialization and higher national income by substituting foreign imports with domestically produced goods. This strategy was often accompanied by other government interventions, including low-interest loans and subsidies to industries, outright government ownership of some strategic industries (especially petroleum), and special tax incentives. These types of strategies were used not only in Latin America but also by East Asian countries such as Taiwan and South Korea.

Meanwhile, another group of underdeveloped countries undertook a more radical form of government intervention: socialism. Karl Marx conceived of socialism as a temporary stage that countries would go through en route to the utopian social order of communism, a radically democratic society in which social rewards would be distributed according to the principle of “from each according to his ability, to each according to his need” and in which governments would become unnecessary and disappear.

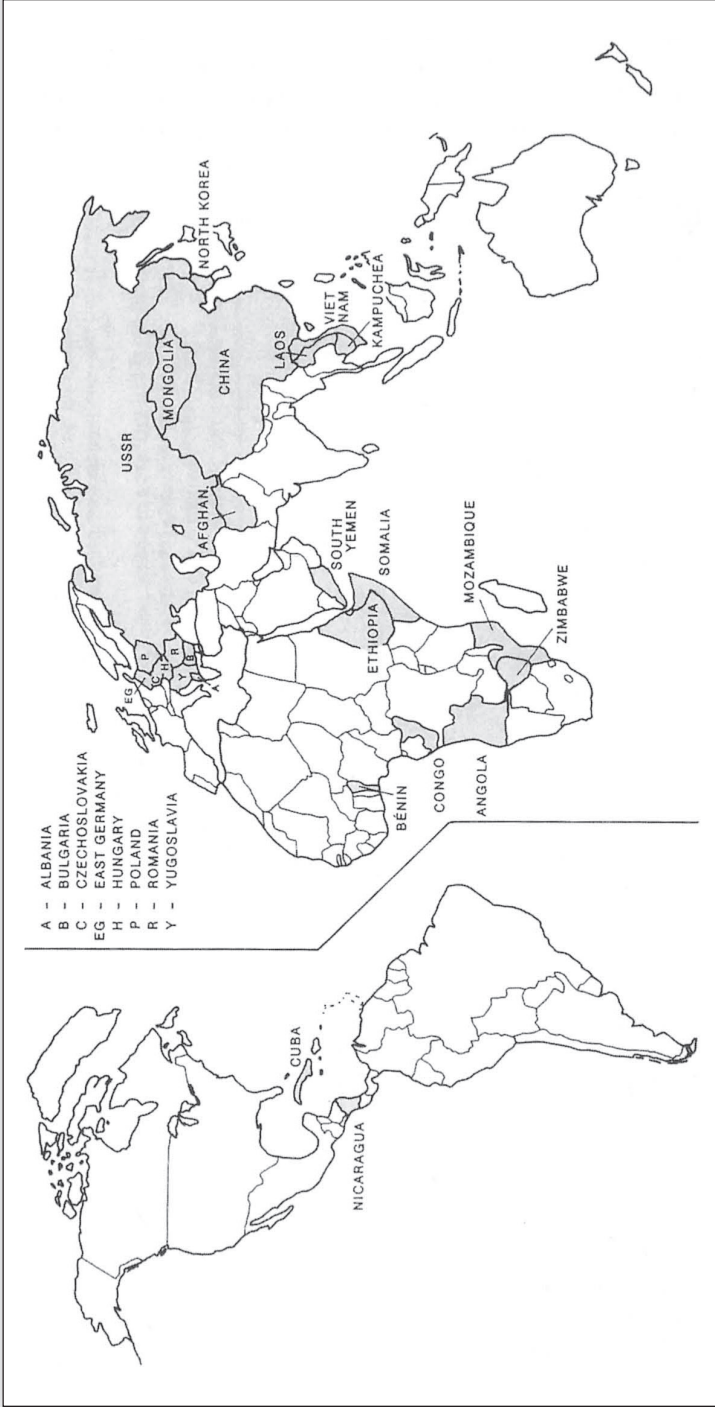
The real-world application of Marx’s ideas turned out to be rather different from what was expected. Socialism was implemented in countries that Marx would have said weren’t ready for it. Marx believed that a nation had

to pass through industrial capitalism to achieve socialism and then communism: Socialism was appropriate only for countries that were already industrialized, such as Germany or England. As it turned out, however, the first country to have a socialist revolution—Russia—was underdeveloped and agrarian. Soviet military occupation subsequently imposed the Soviet model on countries in Eastern and Central Europe, but in many Third World countries, the model was adopted voluntarily by revolutionary nationalist governments, including those of China, Algeria, North Vietnam, Nicaragua, and Cuba (Kornai 1992:22–26).

Exhibit 7.4 illustrates how widespread this system had become by the late 1980s. We will refer to the “really existing socialism” of these countries as **state socialism** to distinguish it from the utopian socialism conceived of by Marx (Konrád and Szelényi 1979). In these state socialist countries, all major productive assets—including farms, factories, banks, and mines—were owned and managed by the government rather than by private individuals or corporations. There was very little private ownership and a very limited role for markets. Although industrialization and growth in national income were not the stated goals of the state socialist model, the Soviet Union, in particular, was able to use them to become a more powerful industrialized country, albeit at a very high human cost (see Gouldner 1978). At the time of its revolution in 1917, Russia was a backward, weak, and underdeveloped country. In contrast, after World War II, the Soviet economy was strong enough to make the Soviet Union a military superpower—and the number one rival of the United States.

Thus far, we have focused on the ways that governments flouted classical economic advice by intervening to promote industrialization and economic growth. However, governments also intervened in important ways to promote the social dimensions of development, such as literacy and life expectancy—a role for states to which the classical economists gave little consideration (although Smith did recognize the role of government in education). During the 20th century, more advanced industrial countries such as the United States, Germany, France, and England developed **welfare state** policies that guaranteed social benefits aimed at promoting social well-being. If we could travel back in time to the end of the 19th century in the United States, we would be shocked by the extreme poverty and inequality, widespread illiteracy, child labor, lack of access to clean drinking water, and so on. The United States in the late 19th century looked, in many respects, like a Third World country. By the middle of the 20th century, in contrast, the United States was a much more humane place because of government actions, including child labor laws, universal access to public education, worker safety laws, Social Security, and public sanitation.

Exhibit 7.4 The State Socialist Countries, 1987



Source: Kornai, J., *The Socialist System: The Political Economy of Communism*. © 1992 by János Kornai. Used with permission of Princeton University Press.

These kinds of policies were made possible in the United States and other advanced countries by increased democratization, the growth of industrial unions, alliances between organized workers and the rural poor, and the rise of powerful social movements for reform (Esping-Andersen 1990; Marshall 1950).

The record of the postwar Third World in addressing these social dimensions of development was spotty. In line with the dominant economic thinking of the day, many developmentalist governments pursued capitalist growth in national income with little thought for social welfare—assuming that the benefits of growth would eventually trickle down to the lowest reaches of society. State socialism also had a mixed social welfare record. Unlike capitalism, which is only an economic system, state socialism was *both* an economic system *and* a political system. The political system associated with the Soviet model was notably lacking in democratic freedoms. Development economist Amartya Sen (2000) argues that democratic freedoms are a critical dimension of development, which he defines as an increase in human freedom and capabilities. Sen also argues that democracy is a means to development: Having governments regularly held accountable for their mistakes—and voted out of office when they fail—helps secure human welfare by inoculating societies against human-made disasters such as the famine that occurred in state socialist China in the period 1958–61, in which tens of millions of people died. Yet paradoxically, among developing countries, state socialist dictatorships were often better at bringing about long-run improvements in human welfare than were capitalist dictatorships (such as those in Zaire and Haiti) or even capitalist democracies (such as India). In Cuba, for example, illiteracy was virtually eliminated from the island after the revolution in 1959; average life expectancy on the island by the late 1980s was 75 years—about the same as in the United States (Pérez-Stable 1993:92; World Bank 1997). In contrast, life expectancy in India as this book goes to press is still only 64 years, reflecting a very high rate of infant mortality (World Bank 2011).

## The Rise of the Washington Consensus

We have seen that despite the advice of classical economists, many nations subsequently attempted to develop using government policies that interfered with market forces. By the end of the 20th century, however, the tide had turned the other way, and many nations adopted the policies of the **Washington Consensus**. This term was coined by a Washington, D.C., economist in the late 1980s to refer to the policies prescribed to developing

countries by top American policy makers, as well as by international financial institutions (IFIs), particularly the World Bank and International Monetary Fund, both located in Washington, D.C. (Williamson 1990). IFIs are multilateral organizations (i.e., owned and run by many governments) that provide financial resources to governments in need, mostly to those of developing countries. The Washington Consensus essentially recommended that developing countries control inflation, open up their economies to international competition and investment, and rely on free markets.

The effects of the Washington Consensus reached far beyond the D.C. beltway. Underdeveloped countries around the world—from Latin America to Africa to Asia to the former socialist bloc—were returning to the ideas of Smith and Ricardo. For example, Mexico privatized its state-owned industries, made its laws more favorable to private agriculture and foreign investment, and eliminated government subsidies of consumer goods. In 1994, the North American Free Trade Agreement (NAFTA) went into effect, eliminating Mexican tariffs on imports from the United States and Canada and creating more favorable conditions for foreign investors. Behind this strategy was a belief that Mexican development is best guaranteed by reliance on the invisible hand of the marketplace and comparative advantage. Mexico wasn't alone; it was one of a great many developing countries that moved in this “market-friendly” direction in the 1980s and 1990s. Because these policies resonated with the ideas of classical or “liberal” economists, they are sometimes referred to as *neoliberalism*.

The endorsement of these policies by developing countries had at least three causes. First, it had become intellectually fashionable among economists to emphasize the defects of state intervention and the virtues of markets. As the well-known economist (and later secretary of the Treasury for the Clinton administration) Lawrence Summers put it: “What’s the single most important thing to learn from an economics course today? What I try to leave my students with is the view that the invisible hand is more powerful than the [hand of the government]. Things will happen in well-organized efforts without direction, controls, plans. That’s the consensus among economists” (quoted in Yergin and Stanislaw 1998:150–51). At that time, when post-socialist or developing country governments sought expert advice about how to develop their economies, many or even most experts were telling them to free up their markets. This was particularly true of the experts at the World Bank, the most influential organization in the development field. The World Bank strongly endorsed Washington Consensus policies starting in the 1980s, both in its research publications and in its lending policies, which we will address shortly (Babb 2009). This faith in the power of markets was also prevalent



among a new generation of U.S.-trained economists who were starting to occupy important positions in the governments of developing countries—from finance ministers to presidents (Babb 2001).

A second reason for the widespread popularity of Washington Consensus-style policies was the apparent failure of the more interventionist alternatives. These failures were easiest to perceive in the state socialist model at a time when the Soviet bloc was beginning to crumble. In state socialist economies, all or almost all production was controlled by the state, private ownership was minimal, and prices were not determined in markets but rather by government officials. Although state socialist countries had some success at improving indices of social welfare (as noted above), they were notoriously bad at providing consumer goods and innovating technologically. The image of Eastern Europeans waiting in endless lines for basic consumer goods was not just Cold War propaganda—it was based in the reality of everyday life for millions of people living under state socialist economies. A Hungarian economist named János Kornai developed an important theory for explaining why economies dominated by state-owned industries were plagued with these sorts of problems. A capitalist firm owned by a private entrepreneur faced what Kornai called **hard budget constraints**, which essentially meant that the owner had to face directly the consequences of his or her own mistakes. If the owner's calculation of risks was incorrect—if, for example, there turned out to be no market for what the firm was manufacturing—the firm would go bankrupt. On the other hand, government managers responsible for making firm decisions under state socialism had only **soft budget constraints**.

Kornai likened the relationship between the firm manager and the government under state socialism to the relationship between child and parent: The parent exerts authority over the child and provides the child with pocket money. In a scenario familiar to many college students who have emptied their bank accounts, Kornai described the result: “The manager has absolute safety. He is sure he will be bailed out. He knows the state will act as a kind father. So the brake on expansion doesn't operate. He says to himself: Why not ask for more money?” (quoted in Minard 1983:66). Because there was no mechanism to divert resources away from unproductive and toward productive investments, there were constant shortages of consumer goods; these shortages, in turn, meant that state socialist economies were “sellers' markets” rather than “buyers' markets,” which meant that there were few incentives to innovate. By the 1970s, it was becoming clear that the Soviet Union's economy was falling farther behind that of the United States, making it increasingly difficult for the Soviets to keep up with the United States in the

arms race (Chirot 1991). In the 1980s, Gorbachev's plan to open his country politically as well as economically ultimately led to the breakup of the Soviet Union and its satellites and the abandonment of state socialism throughout Eastern Europe.

By the 1980s, the failures of state socialism were difficult to ignore. In contrast, the evidence against developmentalism—using the state to promote capitalist industrialization and growth—was more mixed. There were many historical examples of governments that intervened to promote capitalist industrialization and growth and had subsequently thrived. One example was the United States in the 19th century. In the 20th century, many other countries made significant progress under developmentalist regimes. In the section below, we examine some famous East Asian examples of successful developmentalist policies, including in Taiwan, South Korea, and—most recently—China. In Latin America, too, there were some successes. For example, between 1945 and 1970, growth rates in Mexico averaged more than 6%. It wasn't until the beginning of the 1980s that Mexico, along with other Latin American countries, found itself faced with unsustainable foreign debt, stagnant growth, and high inflation. Yet during the heyday of the Washington Consensus, these problems were often interpreted as resulting from the inevitable defects of developmentalism. In this view, the nations of the Third World had relied too heavily on states and forgotten the wisdom of classical economics.

A third reason for the widespread adoption of Washington Consensus policies was that many governments, particularly in Latin America, faced powerful pressures to adopt them. The heyday of the Washington Consensus was also the heyday of **policy conditionality**—in which the World Bank, IMF, and other aid organizations lent governments resources in exchange for policy reforms. With the outbreak of the Third World debt crisis in 1982, many governments found themselves in a poor bargaining position and subsequently signed agreements that committed them to such policies as privatizing state-owned industries, removing protections for domestic industries, and creating more favorable conditions for foreign investment (Babb 2009).

## Sociological Perspectives on Development

Development debates have come a long way since the heyday of the Washington Consensus. It has become more difficult to find development experts who endorse unfettered markets as a panacea for developing countries, and there is considerable debate among these experts as to what the best policies are.

One reason for this new diversity in development thinking is that the evidence does not seem to support the Washington Consensus. Many countries in Latin America that adhered closely to the model in the 1980s and 1990s saw their national incomes stagnate (as can be seen in the case of Mexico in Exhibit 7.1). Meanwhile, the emergence of a new group of development stars—China, Vietnam, and India—seemed to be teaching a very different set of lessons. All three countries experienced rapid growth, rising living standards, and (to a more varied extent) improvements in human welfare. Yet none of them could be described as having followed the Washington Consensus, at least not in any straightforward way. This was particularly obvious in the cases of Vietnam and China, both of which progressed under single-party communist regimes. Both gradually transitioned to market economies but also remained committed to a major government role in economic development in some ways similar to that adopted by the post–World War II Asian Tigers (Rodrik 2008).

As we finish writing this book, no new consensus has arisen to replace the Washington Consensus. In the midst of the current debates, however, two important ideas have arisen that suggest that sociology has become more relevant than ever to the study of development. The first is the idea that markets always function imperfectly, along with the related argument that nonmarket institutions (such as states) need to compensate for market imperfections. A major proponent of this idea (and critic of the Washington Consensus) is Nobel Prize-winning economist Joseph Stiglitz. Stiglitz is famous for accusing proponents of the Washington Consensus of “market fundamentalism”—a dogmatic, literal interpretation of classical economic ideas. In reality, “Adam Smith’s invisible hand theorem,” according to Stiglitz (2005), “was based on extremely stringent conditions. It assumed, for instance, that information was perfect, that there were no information asymmetries, and that markets were complete. . . . These assumptions clearly do not apply even to the best-functioning market economies” (p. 25). Markets are even more imperfect in developing countries, creating an even greater need for nonmarket institutions to compensate. The second idea is that there is no single recipe for economic development (Rodrik 2008). This has even been expressed by the World Bank, the world’s most important peddler of development recipes. A World Bank report issued in 2005 acknowledges that “there is no unique universal set of rules” and calls for respect for diversity in development policies (Nankani 2005:xii).

The acknowledgment of the nonmarket preconditions for development and the potential diversity of development paths has created new opportunities for sociologists to contribute to development debates. We believe that sociologists, to borrow Ricardo’s famous phrase, have a “comparative advantage” in the

study of the nonmarket foundations of economic phenomena. In this section, we look at how sociological analyses of networks, organizations, and cultures enrich our understanding of economic development.

## Networks and Social Capital

If you have ever shopped at an open-air market in a developing country, particularly in the Middle East or South Asia, you know it can be an exciting but sometimes frustrating experience. There are no set prices—when you ask a vendor how much something costs, he or she will inevitably name a price that is far too high. The expectation is that you will then name a price that is far too low, and that you and the vendor will haggle until you have reached a mutually agreeable price somewhere in the middle. As a tourist, however, you are unlikely to have good information about what something should cost. Furthermore, unless you are an expert, you probably don't have a good way of evaluating the quality of what you are buying. All too often, you, the unsuspecting tourist, end up buying what you think is a “priceless antique,” only to discover upon bringing it back to your hotel that you have been hoodwinked. If you return to the scene of the crime to demand your money back, the vendor is likely to deny any recollection of any such sale—and then try to sell you another dubious antiquity.

Although this kind of transaction seems exotic to those of us who are accustomed to buying things at supermarkets and shopping malls, the bazaar economy actually provides a graphic example of what a real-life “free market” might look like. In the absence of countervailing formal or informal institutions (e.g., laws and regulations, community sanctions), markets can be freewheeling institutions in which individual utility maximizers can be expected to lie and cheat. The buyer must beware because the seller knows things that the buyer does not know. As the anthropologist Clifford Geertz (1978) notes in a famous essay, “In the bazaar information is poor, scarce, maldistributed, and intensely valued” (p. 29).

Such problems of information, argues Stiglitz (2005), are particularly prevalent in poor countries and create formidable obstacles to economic development. Imagine how difficult it would be to set up a business in a society in which markets resemble the bazaar. If you wanted to, say, purchase locally manufactured rugs for export, you would have to be constantly vigilant that your suppliers were not selling you substandard goods for an excessive price. Just avoiding being cheated would require a considerable ongoing expenditure of time and resources.

The simplest solution is to find one or two trustworthy suppliers and then rely exclusively on them for your business—a phenomenon Geertz refers to

as “clientelization” and economic sociologists refer to as “relational contracting” (see Dore 1983). By establishing yourself as a regular client, you give the vendor an incentive not to cheat: Although deceiving you once may yield a higher profit in the short run, in the long run it would lead to the regrettable loss of a valuable client. In short, establishing a relationship—a node in a social network—helps compensate for information problems, fosters trust, and allows the wheels of business to turn more quickly and efficiently than they otherwise would. Relational contracting can be positive for economic development because it lowers “transaction costs” (the costs involved in getting cheated, in searching for good information, in hiring lawyers to draft ironclad contracts, and so on). For example, in a study of Japan’s booming fabric industry in the 1960s, sociologist Ronald Dore (1983) found that the industry was not made up of large, bureaucratically organized firms, but rather of networks of small firms doing business with one another—engaged in “moralized trading relationships of mutual goodwill” (p. 460).

With relational contracting, a long-term, cordial business relationship is created for the purpose of doing good business. Some scholars, however, argue that the real development payoff lies in being able to exploit more intense *preexisting* social ties. Social relationships that can be used for economic ends constitute **social capital**, or “the ability to secure resources by membership in social networks or larger social structures” (Portes and Landolt 2000:532). Strong and dense family, religious, cultural, or community ties can help foster trust in ways that enable the establishment of trading relationships, foster business partnerships, and even bring borrowers and creditors together. For example, during his travels across the United States in 1904, the German sociologist Max Weber attended a baptism in North Carolina and was surprised to discover that the convert was being baptized so that he could start a local bank. His being a member of a particular Baptist sect would convince people that he could be trusted with their money—not only because the church was known for converts of impeccable moral character but also because it was committed to repaying the man’s creditors if he got into financial trouble (Weber 1946c: 304–5). At a time when there was little government financial regulation, no federal bank bailouts, and no FDIC, a religious institution provided social capital that allowed for the establishment of a credit institution that may have been beneficial to the local economy.

Not all social capital is good for business or good for development, however. Social ties can lead to the squandering of economic resources rather than their accumulation and investment. For example, sociologists Alejandro Portes and Patricia Landolt (2000:533) note that successful artisans in the

highlands of Ecuador have been converting to Protestantism—not necessarily for spiritual reasons, but to avoid having to make the large payments that successful businesspeople are traditionally expected make to Catholic festivals. The ability of the church to claim these resources is a form of social capital; it is arguably good for fostering community, but is probably not good for growing local businesses. The key for economic development, it seems, is to foster the *right kind* of social capital.

On the face of it, the rise of economic globalization seems as if it would make markets more anonymous and social networks less important. In reality, however, it has made networks more important than ever. Economic globalization has been increasing the importance of network forms of production over production within large, bureaucratically organized firms (Castells 1996). If you buy a Dell laptop, it was not manufactured by the Dell corporation in Austin, Texas. Rather, it was assembled by Dell from myriad component parts manufactured by smaller firms in countries all over the world. If you buy a Gap T-shirt, it was not manufactured by the Gap; rather, the Gap bought its T-shirts from a “jobber,” who purchased them from subcontractors who bought from small firms in developing countries.

Some sociologists of development suggest that poor countries interested in becoming more wealthy need to figure out ways to insert themselves strategically into these global production networks, or “commodity chains” (Gereffi 1994). Countries with preexisting stocks of transnational social capital may have an advantage in tapping into global networks of production and investment. In a study of foreign direct investment in Eastern Europe, one sociologist found that countries with preexisting personal and business networks between the investors and hosts (before the fall of state socialism) received significantly more investment than did countries that lacked these ties (Bandelj 2002).

Transnational networks may also help foster investment in the types of development projects usually associated with governments or international aid agencies. Many sociologists who study migration argue that such networks have become much more important in recent years. Unlike previous generations of immigrants who assimilated into their new countries (as in “the American melting pot”), transnational migrants maintain strong ties to their originating communities and frequently travel back and forth. A transnational migrant from a poor country who works in a rich country such as the United States may be willing to contribute some of the money he or she earns to help his or her community back home—depending, of course, on how strongly obligated the individual feels (i.e., depending on the stock of social capital). Such remittances are particularly important for a country such as El Salvador, where a very high proportion of the population has

migrated abroad. Migrants from the same communities have established *comités de pueblo*, or hometown associations, which organize social and cultural events in their hometowns and raise money for improvement projects such as roads and electrification. Significantly, it appears that the *comités* are able to foster feelings of community spirit, both among migrants and between migrants and hometown dwellers, thereby increasing the stock of social capital (Portes and Landolt 2000: 542–43).

Being a successful economic developer in the new global economy may depend partly on tapping into global networks. However, strong *local* networks may be even more important. To understand why, it helps to look to the work of Albert O. Hirschman, a development economist with a strong sociological imagination. Development, according to Hirschman (1958), does not result from the mobilization of an entire economy at once but, rather, from the mobilization of key strategic sectors that could pull the rest of the economy along with them. Thus, for example, a dynamic textile industry can create demand for cotton in the countryside, for transportation, for fashion designers, for mechanical engineers, and so on. This “pushing” and “pulling” process results from the creation of what Hirschman calls “forward-and-backward linkages.”

In other words, an investment has its greatest developmental impact to the extent that it is (or becomes) embedded in domestic networks. Some sociologists have argued that foreign investors are particularly unlikely to establish the forward-and-backward linkages that Hirschman views as the key to development. In abstract economic models, foreign and domestic investments are seen as perfect substitutes, but in practice they may differ in significant ways. For example, in his study of development in Brazil, Peter Evans (1979) found that foreign firms in Brazil were unwilling to take the same risks as domestic investors with the same amount of capital; as a result, these firms made only minimal contributions to economic development. Foreign firms tended to use “tried-and-true” production methods from the home country rather than adapt to local conditions; this meant using capital-intensive techniques developed in countries where wages were high rather than applying labor-intensive techniques that took advantage of the huge pool of unemployed Brazilian labor. In addition, foreign firms tended to try to persuade Brazilian consumers to buy products developed for the home country rather than address the particular demands of local consumers. Because Brazilians were on average much poorer than First World consumers and their incomes were distributed more unequally, expensive products such as automobiles had to be oriented toward a tiny elite market rather than a mass market—again limiting employment possibilities. Most important, foreign firms in Brazil were

unwilling to invest in locally generated technologies, to hire local professionals, or to use more than a minimum of local inputs and equipment.

As a result, foreign firms in Brazil created few forward-and-backward linkages, and their contribution to local economies was limited to job creation for a small number of workers. The reason, according to Evans (1979), was that investors made boundedly (rather than perfectly) rational decisions under conditions of imperfect information: “A rational profit maximizer who grew up in Kansas City and works in Chicago brings different information to a decision from one who grew up in São Paulo and works there” (p. 36). With their imperfect understanding of local conditions, foreign investors made decisions that were less developmentally healthy than those that a better-informed investor would have made.

Export processing zones (EPZs) around the world today are another good example of how foreign investment can fail to produce the local networks that foster development. EPZs are special geographic areas set aside by the governments of countries such as Mexico and the Dominican Republic for “free trade”: Foreign investors are sheltered from taxes if they set up manufacturing plants in EPZs. This strategy creates jobs for local workers but typically doesn’t create forward-and-backward linkages; for example, apparel manufacturers will simply import precut components to an EPZ, use local labor to stitch them together, and then ship the finished items back out again to be marketed in the United States.

Another reason foreign investment may fail to be positive for development is that foreign investors may not be committed to sticking around. The reason for this goes back to bounded rationality and the role of social networks. Andrew Schrank (2008) studied investors in a region of the Dominican Republic famous for manufacturing apparel for companies such as Levi Strauss. Some of the investors were foreign and others were Dominican. With the passage of NAFTA in the 1990s, it suddenly became cheaper to move operations to Mexico, and many investors relocated, leaving empty factories and unemployed workers in their wake. Schrank found that Dominican-owned firms were significantly less likely to move to Mexico. The reason, he discovered, had partly to do with the bounded rationality of local investors—as one Dominican businessman put it, “I don’t know anything about Mexico” (p. 15). Still another reason was that Dominican investors were able to exploit local personal and professional ties—for example, to banks or to government officials—that were unavailable to international firms, and that made staying local much more attractive. With their local knowledge and social ties, these investors stayed in the Dominican Republic and continued to provide jobs for local workers.



The importance of networks in economic development has not been sufficiently explored, although it has many possible implications for policy. We will mention only two here. The first implication is that the postwar developmentalists were right to argue for the creation of a strong domestic capitalist class. Historical evidence supports this. A comparison of two countries widely considered to have developed successfully in the 1970s and 1980s, Taiwan and South Korea, with two that were widely considered to be less successful, Brazil and Mexico, illustrates this point well. In comparison with the latter countries, the former countries had much higher growth in national income during this period and much better social indicators. Both pairs of countries went through a period of “import-substituting industrialization”—that is to say, a period of protecting domestic industries from foreign competition to help build a strong domestically owned industrial base. They also provided subsidies and other benefits to domestic firms. Unlike Brazil and Mexico, however, Taiwan and South Korea subsequently moved to phases of “export-oriented industrialization”: Rather than allowing domestic firms to become fat and complacent, these nations forced them to become internationally competitive—or to go bankrupt. The domestic firms that were initially protected and nurtured by the state later became successful exporters that led economic growth (Hyundai is a well-known example). By the end of the 1980s, the two Asian countries had become far more successful exporters than Mexico or Brazil, as Exhibit 7.5 illustrates. Significantly, they had also been more successful at creating a domestic capitalist class: In contrast to Latin America, their economies were dominated by domestic rather than foreign firms (Gereffi and Wyman 1990; Haggard 1990:193; Stallings 1990; Wade 1990; Woo 1991).

Most development experts agree that the governments of underdeveloped countries need to provide incentives for foreign investment, such as stable institutional environments and reliable information. But to foster strong local firms, and to extract the greatest possible development impact from each dollar of investment, the evidence suggests, governments also

**Exhibit 7.5** Exports as Percentage of GDP, Mexico and South Korea, 1965 and 1987

	1965	1987
Mexico	5	15
South Korea	7	39

Source: Gereffi (1990).

need to drive hard bargains with foreign investors. The strong East Asian performers of the late 20th century (e.g., Taiwan, Korea, and Singapore) almost all placed conditions on foreign investment. These included, for example, “technology transfer” agreements with foreign investors, which meant that local firms could benefit from foreign firms’ superior knowledge and technology, and “local content requirements” that forced foreign firms to create backward linkages into local economies (Lall 2005). East Asia’s newest and biggest rising star, China, has been making similar bargains with foreign investors and apparently having similarly positive results (see Johnson 1997:26).

A second policy implication of our survey of networks is that the governments of developing countries would benefit from thinking creatively about how to exploit social networks—or perhaps even how to *create* social networks—for developmental purposes. For example, Sean O’Riain (2004) argues that Ireland’s spectacular economic success in the 1990s was fostered by a “developmental network state,” which was able to harness foreign investment to benefit local networks of high-tech firms.

Of course, the willingness and ability of a government either to negotiate with foreign firms to pursue developmental goals or to nurture domestic networks depends on a type of government official very different from that supposed by the *homo economicus* model—an issue to which we now turn.

## Organizations and the State

A state, in the words of the German sociologist Max Weber (1946b), is an organization that “successfully upholds a claim on the monopoly of legitimate violence” within a given geographical territory (p. 78). States—or “governments” as they are more commonly called—are organizations that can make people do things that they would not otherwise do, such as pay taxes or serve in the military. States are important to development because they can potentially do things that markets can’t do on their own. Most economists who study development would agree that states should provide public goods such as infrastructure, education, and law enforcement (even Adam Smith recognized that government has an important role to play). Public goods, which everybody can enjoy, potentially suffer from what economists call the “free rider” problem: People want to use them, but they don’t want to pay for them. By providing public goods (and forcing people to pay for them), states solve the free rider problem and help establish foundations of development, such as educated populations and ways of transporting goods and people from Point A to Point B. Beyond

this, however, development experts disagree about what states should be doing to promote development (for example, not all would agree that states should nurture infant industries as Latin America and East Asian governments have).

If we look around the world today, it is clear that not all states have been successful at fostering economic development. How can we describe the difference between a state that is good for development and one that is harmful—and how can we explain it? If we use the economists' tool kit, we might come to the conclusion that states are always and everywhere bad for economic development. One group of economists (the "public choice" school) sees government bureaucracies as inherently problematic (Buchanan, Tollison, and Tullock 1980). Their models assume that people behave as self-interested, atomistic individuals in all spheres of their lives; a government official is just another example of Adam Smith's *homo economicus*. Given a trade-off between his or her own personal good and the greater good, the official will generally choose the former; thus, for example, given the choice between awarding a government railroad contract to a close relative (and being rewarded with a bribe or campaign contribution) or awarding it to the best bidder (and forgoing the monetary reward), the official will put his or her own individual good over the greater good of economic development. Small wonder that so many poor countries have governments that are rife with corruption and inefficiency, and that fail to improve the lives of their people.

But how can we explain those state bureaucracies that appear to have played a more positive role in development? This is a sociological question. Weber studied bureaucracies of many nations and came up with an "ideal type" (roughly, an abstract model) of bureaucracy as a hierarchical, meritocratic organization in which bureaucrats perform tasks in the organizational interest. Of course, Weber knew about corruption and recognized his "ideal type" for what it was—an ideal model of bureaucracy rather than one matched by all actually existing bureaucracies. Some bureaucracies adhere more closely to this ideal type than others. In more ideal-typical bureaucracies, officials pursue organizational goals because of formal and informal sanctions but also because of organizational legitimacy; they believe in the organization and therefore take the good of the organization as their own.

More recently, the sociologist Peter Evans (1992, 1995) has studied historical examples of underdeveloped country governments, from "predatory states" to "developmental states." Quintessential examples of predatory states were the governments of Zaire (before its revolution in 1997) and Haiti (before the end of its military government in the mid-1990s). Predatory states behave exactly as economic theory predicts that they should: They are

collections of self-interested actors who use coercion and corruption to obtain material rewards. Such states bleed local economies dry and cause economic stagnation rather than development.

According to Evans, developmental states behave quite differently. They remove obstacles to development that markets cannot remove on their own, providing institutional frameworks and systems of incentives that encourage entrepreneurs to take risks. One good example of such a state is that of postwar Japan, which played a crucial role in providing capital to expanding industries. Overseeing postwar industrial policy in Japan was the Ministry of International Trade and Industry (MITI), which, as a highly efficient organization staffed by some of Japan's most talented university graduates, came close to Weber's ideal type of bureaucracy (Evans 1995:47–48). During the postwar period, Japanese government bureaucracies successfully used government interventions to go beyond the minimalist standards endorsed by the neoliberals (Gao 1997). These included protective tariffs for domestic industries and tight control over foreign investment, which was allowed to enter only under strict conditions (Evans 1995:100). As a result, the Japanese government was able to *create* comparative advantage in industries such as computers—rather than merely relying on the comparative advantages it already had, as the Washington Consensus prescribed. As we have shown above, similar (although not identical) strategies were later used by other East Asian countries such as Taiwan, Korea, and Singapore—and now are appearing in a somewhat different form in China.

Why didn't Japan's MITI officials simply protect companies in exchange for bribes, as public choice theory would predict, and end up with inefficient industries dependent on state protection? What is the key to creating successful government organizations such as MITI to oversee economic development? Evans's answer is that they must first be autonomous enough from the entrepreneurs they are supervising so as not to become the corrupt government patrons of favored private-sector clients—as in the *homo economicus* model. To this end, government bureaus should be insulated from politics and should consist of stable, meritocratic hierarchies that individual bureaucrats can climb through their careers regardless of what political party happens to be in power. This form of organization is known as a career civil service. But such autonomy is not enough. The bureaus must also be *embedded* in society in ways that facilitate the informal exchange of information between government bureaucrats and the private sector. In Japan, informal social networks among elite university graduates—some of whom went on to be government bureaucrats while others became leading industrialists—were particularly important (Evans 1995:49).

Evans's argument is mainly aimed at explaining how states can play a positive role in industrialization and economic growth. Other sociologists,

however, have made a parallel argument for the role of states in social development—in alleviating poverty, providing universal education and health care, and so on. For example, José Itzigsohn (2000) conducted a comparative study of the experiences of workers in Costa Rica and the Dominican Republic in the 1980s and 1990s. Although workers in both countries were hurt by the effects of the Latin American debt crisis, high unemployment, low growth, and labor market deregulation prescribed by the Washington Consensus, Costa Rican workers fared significantly better than Dominican ones. The reason for the difference, according to Itzigsohn, was that the Costa Rican state provided far more effective policies for social protection—policies that were embedded in Costa Rica’s stronger democratic tradition and more independent state institutions.

Similarly, in his discussion of the Indian state of Kerala, Patrick Heller (1999) presents a compelling example of how governments can make a positive difference for social development. At the time Heller was studying the state, Kerala was poor and its rates of growth relatively low. However, its indices of social welfare were (and continue to be) spectacular: Despite its poverty—and in stark contrast to other states in India—Kerala had levels of literacy and life expectancy that approached those of developed countries. These impressive accomplishments resulted from good government policies, including both land redistribution to poor farmers and expanded access to government-provided social benefits, such as education and health care. The Kerala government’s capacity to promote these policies, in turn, could ultimately be traced to social movements among Kerala’s poor, which led to the creation of better state institutions—and stronger democratic institutions—than those that prevailed in other Indian states. In a sense, Kerala’s success was embedded in the mobilization of marginalized social groups.

Clearly, states can use their unique organizational capacities to play a positive role in economic development. It would be a mistake, however, to conclude that developing countries should all approach development in exactly the same ways. We now turn to the role of culture in development strategies.

## Culture and Multiple Capitalisms

Sociologists have long been interested in how cultures may encourage or discourage capitalist development. For example, Weber thought that traditional societies impose cultural barriers to the development of capitalism—for example, in Europe during the Middle Ages, there were all kinds of laws and customs limiting who could trade, what could be bought and sold, the interest that could be charged on loans, and so on. The erosion of such cultural barriers was one of the factors that made the rise of European capitalism possible.

About 40 or 50 years ago, a school of thought known as modernization theory suggested that traditional societies needed to imitate more advanced societies' path to successful capitalist modernization. Like the Washington Consensus, modernization theory assumed that there is a single path to economic success. However, in contrast to the Washington Consensus, which had little to say about culture, modernization theorists often argued that transforming individuals' traditional cultural attitudes was a prerequisite of successful modernization (Inkeles 1969).

Nowadays, sociologists of development tend to have a different view of culture from that of modernization theorists. For example, they reject the idea that there is a clear distinction between "traditional" and "modern" cultures, or that developing countries need to adopt Western cultural values in order to succeed—with so many East Asian success stories, it is much harder to make this argument than it once was. Rather than viewing culture as a set of attitudes in people's heads, the contemporary approach tends to view culture as a "tool kit" of symbols, stories, rituals, and world-views, which people may use in varying configurations to solve different kinds of problems" (Swidler 1986: 273). Different countries have different cultural endowments, which lead to distinct configurations of networks, organizations, and institutions.

For example, among the richest, most highly developed countries in the world, there are some striking and persistent differences. Capitalism in the United States is quite different from capitalism in Germany or capitalism in Japan. Whereas industry in the United States tends to rely on a large, relatively unskilled workforce with a general education, in Germany, workers are highly trained for jobs in specific areas through a system of apprenticeships. In the United States workers move from job to job with great frequency, whereas the Japanese economy rests on a system of reciprocal commitment between workers and employers: The workers are loyal to the company, and the company guarantees them lifetime employment. The resulting commitment of workers to the firm is often invoked as a reason that many Japanese firms can manufacture products of such high quality (Hollingsworth 1997).

On the surface, the East Asian development success stories of the 20th century seem to have much in common. In fact, however, there were some very important differences among East Asian countries in terms of their economic organization. In their study of Japan, Taiwan, and South Korea, Hamilton and Biggart (1988) found striking variations in such organization. South Korean development success was dominated by a group of large, hierarchical firms known as *chaebol*, which used their close ties to the government to obtain financing and other benefits. Like the Korean economy, the

Japanese economy was dominated by large firms, but with stronger ties to one another than in Korea, and also strongly connected to subcontractors. In contrast to both of these cases, Taiwanese economic growth was dominated by small-to-medium family firms, which, instead of growing into large incorporated companies, split up and diversified as they got larger (Hamilton and Biggart 1988:S59–S66). Despite these differences, all three countries succeeded in dramatically improving the lives of their people during the 20th century.

These different forms of economic organization, in turn, were embedded in the countries' different political institutions and cultures. The South Korean postwar economy developed within the context of a strong, centralized state that encouraged the formation of large conglomerates as its partners in economic development. In contrast, the postwar Taiwanese state was much less directly involved with business, following a philosophy of "planning within the context of a free economy" (Hamilton and Biggart 1988:78). Whereas the Korean government was constructed on the model of the strong Confucian state with a central ruler, the Taiwanese government was shaped by the need of Chiang Kai-shek (the mainland Chinese nationalist leader who ruled Taiwan after the Chinese revolution) to avoid problems with the native Taiwanese; the result in Taiwan was a model of "a state that upholds moral principles . . . that explicitly [allow] no corruption and unfair wealth, and that 'leaves the people at rest'" (Hamilton and Biggart 1988:S83). This left the Taiwanese economy to develop along lines that suited Taiwanese culture, in which there was a long-standing tradition of splitting up the family inheritance among the sons of a household.

These examples suggest that development, where it occurs, takes advantage of the particular social features of the country in which it is occurring (Biggart and Guillén 1999). China's current economic success seems to provide further evidence that the best way for a country to pursue development is to use the organizational, social, and cultural tools at hand. Since 1978, China has been pursuing reforms designed to improve economic performance through harnessing the power of markets.

However, China's success in the area of economic development does not fit easily into conventional Washington Consensus wisdom. Some sociologists have pointed out that China's recipe is actually a "hybrid" model in which strong elements of the old state socialist system endured, becoming only slowly less important over time (Nee 1992; Nee and Matthews 1996; Walder 1995). For example, although China's economy was marketized (i.e., made to produce for private markets), it was definitely *not* initially privatized (i.e., sold by the state to individual capitalists). Cooperative farms were placed under the "household responsibility system" so that peasant families could directly reap the rewards of their efforts, even though they did not

privately own the land they were working. Control of state industries was similarly devolved to provincial and local governments (Nee and Matthews 1996:401–5). In his study of the public industrial sector in China, Walder (1995) found that industries managed by county, township, and village governments had growth rates well above the already high national average. These industries operated under a system of fiscal contracting that obliged them to give the government a fixed financial return, allowing managers to keep any residual financial return—an indirect incentive to increase profitability. Local state-owned firms were under the control of local officials rather than distant bureaucrats in Beijing and did not suffer from the same problems of information as national industries; local officials could immediately spot problems and opportunities and act on them. Thus, China was able to pursue a development path that harnessed the power of existing Chinese institutions in ways that probably could not be replicated elsewhere.

As economic reform proceeds in China and the nation adopts some Western capitalist institutions (such as property rights and contract law), more purely private firms are being established (Nee 1992). Nevertheless, the form of capitalism that eventually emerges is likely to have a particularly Chinese flavor. Boisot and Child (1996) observe that the markets in China are evolving along the lines of long-standing institutional and cultural arrangements, leading to a form of “network capitalism.” Many business transactions seem to be settled within the context of networks based on interpersonal reciprocal obligations known as *guanxi*.

## Conclusion

For hundreds of years, people have been searching for solutions to the problems of poor countries. Some countries have succeeded in becoming wealthier and improving the lives of their people—and others have been less successful. Development experts disagree about what lessons should be drawn from this long historical record, but today there is a healthy debate that includes arguments about the nonmarket foundations of economic development and that acknowledges that different countries may have different paths. In the end, such arguments may benefit both the sociology of development and developing countries.