I

The Challenge of Uneven Development

I. DEVELOPMENT PUZZLES

Students of economic development have commonly focused on the question of why some countries grow and others stagnate, and with good reason. Empirically, the spectacular income gap separating the world’s rich and poor nations has become “the central economic fact of our time.”¹ This gap, moreover, now extends beyond the industrialized vs. developing worlds to stark differences among developers.² The rich–poor gap has defied easy theoretical explanations. Cultural explanations, for example, foundered on the unexpected success of East Asian countries whose Confucian ethic had previously been identified as an obstacle to growth.³ Initial endowments of assets such as human resources or manufacturing experience failed to explain the disappointing performance of countries such as the Philippines.⁴ Regime type – democracy or authoritarianism – failed to

¹ Rodrik (2003, 1). The ratio of differences in per capita incomes between the richest and poorest countries rose from 3 to 1 in 1820 to 71 to 1 in 1992 (Milanovic 2005, 46). This inequality reflects growth by some and stagnation by many, not simply the rich growing more than others (Ibid. 131–133).

² The starkest difference, between East Asia and Africa, is epitomized by the fact that GDP per capita were roughly the same for South Korea and Mozambique in 1960 but diverged to $7,000 vs. $700 respectively by 1992 (Pritchett 2003, 127). Differences have also emerged within regions, as reflected in the poor performance of the Philippines, relative to, Taiwan, or sustained growth rates in Mauritius and Botswana in contrast to Africa’s overall stagnation (Acemoglu, Johnson, and Robinson 2001, 79; Subramanian and Roy 2003).

³ On the changing perceptions of Confucianism, see e.g. Morawetz (1980).

⁴ Booth (1999).
correlate with variation in development outcomes. Postwar development economists’ belief that large, state-led projects could liberate entrepreneurs from traditional practices and other rigidities ran up against Latin America’s state-led stagnation and Africa’s institutional bloat. Finally, the fact that global income levels exhibit not convergence but “Divergence, Big Time,” has undermined the claims of neoclassical economists. As one long-time practitioner notes, we economists have tried to find the precious object, the key that would enable the poor tropics to become rich. We thought we had found the elixir many different times. The precious objects we offered ranged from foreign aid to investment in machines, from fostering education to controlling population growth, from giving loans conditional on reforms to giving debt relief conditional on reforms. None has delivered as promised.

While empirically and theoretically compelling, this emphasis on the “poor tropics” implies that little growth has occurred in the developing world. In so doing, it neglects the growth puzzle addressed in this book – namely, divergence among (and in some cases within) more successful developing countries. Although the poorest countries fared much worse than the rich, there has been growth among non-OECD countries, with some developing countries growing more than others. As Alice Amsden has argued, “a handful of countries outside the North Atlantic – a group she labels ‘the rest’ – rose to the ranks of world-class competitors in a wide range of mid-technology industries.”

Within “the rest,” countries such as Brazil, Argentina, Mexico, Turkey, Malaysia, Chile, and Thailand, have reached significant, albeit still constrained levels of development. They have increased the role of manufacturing in their economies, expanded the range of goods they produce, moved into more technology-intensive areas, and broadened their range of exports. Such “structural change” is a significant achievement. It has involved greater specialization, promoted new skills, and reduced vulnerability to product-
sector-specific shocks. However, these countries have had a harder time “upgrading” their economies – moving into higher value-added products, at high levels of efficiency, with local inputs. As I discuss later, it is precisely such upgrading that has distinguished three of the East Asian newly industrialized countries (NICs) – Singapore, Taiwan and South Korea from other members of “the rest.”

Accounting for these differences among successful developers is empirically important and theoretically challenging. Understanding why some countries have a hard time moving beyond sectoral diversification bears on the ability of middle-income developing countries to sustain growth in the face of new globalization pressures. Liberalized trade, new competitors, more volatile markets, and new technologies have shortened the period of time in which countries can grow on the basis of low costs, low skills, and high volumes. The difficulties of moving beyond diversification also pose theoretical challenges equal to those raised in the rich vs. poor puzzle discussed earlier. Indeed, the performance of these “middle cases” is under-theorized. I suspect this reflects the fact that much of the otherwise valuable upgrading-related literature on innovation lumps these mixed performers into existing categories of success or failure. Equally important, it ignores the institutional and political basis of mixed performance.

Several scholars have begun to address these shortcomings. Amsden, for example, has argued that the limitations of otherwise impressive developers lie in their institutional weaknesses. These countries have emphasized macroeconomic stability rather than creating mechanisms through which their workers and firms develop the capacity to absorb and build on modern technology. They have, in other words, focused on “getting the prices ‘right’ and buying skills,” as opposed to the NICs’ strategies of “getting the institutions ‘right’ and building skills.” In a similar vein, Natasha Hamilton-Hart has argued that economic sustainability is less a function of policy choice than of “consistent implementation …” Implementation requires institutional capacity, but “getting the institutions right “is not
easy. Atul Kohli has emphasized institutional strength as a key to the success of countries such as South Korea, noting that such capacities “are difficult to construct, even more difficult to institutionalize, and are not found in abundance in the developing world.”\(^{18}\) Robert Bates\(^ {19}\) has argued that while institutions are critical for development, they typically emerge not as efficient responses to new market conditions but out of the rough and tumble of politics.

In this book, I build on these insights by specifying the kinds of institutional capacities demanded by different development tasks and the conditions under which political elites will attempt to build such capacities. My hope is that this analysis will advance the transition from specifying what governments should do to the “economics and politics of how to accomplish the ‘what’.”\(^ {20}\) My core arguments, outlined later in this chapter and fleshed out more fully in Chapter 3, can be summarized as follows:

Different levels of development require goodness of fit between the tasks involved and the capacities of institutions – the norms, rules, and organizations that “govern” economic activities.\(^ {21}\) This “demand-side” account builds on a core contention of new institutional economics (NIE) – namely, that “the appropriate institutions of governance” depend on the attributes of the problem to be addressed.\(^ {22}\) We extend and apply this insight by specifying the attributes – the difficulties – of development problems and requisite institutions of governance. As suggested by Hamilton-Hart’s question about types of growth – “Capacities for What?”\(^ {23}\) – economic development is not of a piece. Different levels of development involve tasks – understood as collective action problems – that vary in difficulty. Specifically, while structural change poses important challenges involved in mobilizing and investing funds in new activities, the difficulties of upgrading, involving learning and linkages, are even greater. Put differently, the interdependencies inherent in upgrading are particularly complex. Managing or “governing” such interdependencies in turn requires different,

\(^{18}\) Kohli (2004, 382).
\(^{19}\) Bates (1988; 1995).
\(^{21}\) On defining institutions to include organizations, see the review in Doner and Schneider (2000). We equate institutions with “governance” mechanisms. By “governance” we mean the process through which economic and political institutions manage their interdependencies by coordinating their diverging interests. For an overview, see Ahrens (2002, 119–132). The core of this definition comes from Williamson, for whom governance structures refer to modes of organizing transactions (e.g., 1985).
\(^{22}\) Ahrens (2002, 125); see also Aron (2000, 14).
indeed greater, institutional capacities. Countries facing the same collective action problems with different institutional capacities will differ in their development outcomes. Turning to the “supply side,” why would national leaders spend valuable time and resources to build institutional capacities appropriate for upgrading rather than buying off clients with side payments? My answer is that they will only do so when faced with severe security and popular pressures on the one hand, and scarce resources with which to satisfy these pressures on the other. Such pressures serve both to motivate political leaders to construct growth-promoting, economic institutions and to concentrate the political structures through which elites operate. It is largely because such pressures are unusual that upgrading is so infrequent. In sum, I argue that (1) particular sets of institutional capacities and arrangements promote some levels of growth and not others, and (2) institutional capacities vary with pressures on political elites.

I assess these arguments through comparative – historical, cross-sectoral, and cross-national – analysis of growth in Thailand. Described as a “vexingly ‘hybrid’ image of both success and failure,” Thailand has achieved stunning GDP growth rates and has diversified out of a small number of agricultural products to become a global export leader in a wide range of agricultural and industrial goods. Its performance made it one of the World Bank’s “High Performing Asian Economies,” an “Economic Miracle,” and a probable Fifth Tiger. Yet this impressive performance has been due largely to the efficient accumulation and mobilization of factor inputs “... rather than improvements in productivity.” These weaknesses emerged in the mid-to-late 1990s when the country’s labor-intensive exports plunged, the stock market dropped, and Thailand became the first victim of the 1997 Asian economic crisis. The crisis transformed the country from “a miracle to needing one,” forcing the authors of the popular Thailand’s...
Boom! to change the title of their revised edition to *Thailand’s Boom and Bust*.* The country’s postcrisis growth rates have recovered, but as described later in this book, its productivity problems remain. Indeed, neoclassical economists’ skepticism that East Asia’s miracle growth reflected more “perspiration than inspiration” – more factor accumulation, characteristic of structural change, than innovation, characteristic of upgrading – may apply more to Thailand than to Singapore, South Korea, or Taiwan.* In this study, I aim to shed light on the bases of this difference.

I do so first by establishing the core puzzles. Chapter 2 begins by reviewing the Thai economy’s impressive achievements and persistent weaknesses. It then draws on Thai and other national experiences to demonstrate the shortcomings of alternative explanations, such as education and political regime type, and to suggest the value of an account that combines institutional capacities with political considerations. My own approach, presented in Chapter 3, constitutes the basis for the comparative, empirical analyses. Chapter 4 traces the postwar evolution of Thai institutions in the face of shifting political constraints. This serves both as an initial test of our supply-side arguments and as country-level background for the sectoral cases that follow.

Chapters 5–7 analyze Thai growth in three sectors – sugar, textiles/garments, and automobiles.* Each chapter also compares Thai sectoral performance with two national “shadow cases” – one a stronger performer, the other a weaker one. As described at the end of this chapter, these analyses provide opportunities to assess our arguments within and across both sectors that pose different sets of challenges to developing country firms and countries that provide different institutional and political contexts in which firms operate. Taken together, they allow me to explain, for example, (1) why the Philippines sugar industry deteriorated even as Thailand sugar exports grew, while Brazil ascended to global sugar dominance by resolving productivity problems that continue to plague the Thais; (2) why Thailand has been so successful at promoting investments in the textile industry but has failed to develop the midstream and upstream expertise, such as in dyeing and printing, so important to Taiwan’s textile

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34 For skeptical views, see e.g., Young (1994); and Kim and Lau (1994). For a critical response, see Haggard and Kim (1997).
35 Sectors are used here in the sense of “the sequence of activities required to make a product or provide a service” (Schmitz 2005, 4), and thus involving “the design, production and marketing of a good or service” (Gereffi 2005). See also Kaplinsky (2005, Ch. 5).
success; and (3) why Thailand has become a center of global pickup truck assembly but is increasingly devoid of indigenous auto parts producers.

The rest of this chapter lays groundwork for the subsequent analysis. The following two sections explain my focus on different growth challenges. Section II establishes the distinction between structural change and upgrading, especially as it is expressed in East Asia. Section III then addresses the “so what” question: How does upgrading influence a country’s inequality and its ability to sustain growth? Section IV briefly introduces our explanation for such uneven performance (to be fleshed out in Chapter 3). Section V presents the benefits of examining Thailand in comparative perspective and outlines the book’s design for doing so.

II. DEVELOPMENT DISTINCTIONS

In the last decade, several scholars have gone beyond rich vs. poor distinctions to provide a more variegated image of development stages. Drawing on multiple case studies, Dani Rodrik,\(^{36}\) for example, has argued that the “transition from a low-income equilibrium to a state of rapid growth” may be qualitatively different from “the process of reigniting or sustaining growth for a middle-income country.” Peter Evans has more squarely addressed the challenges of middle-income developers by distinguishing among (1) static efficiency, (2) the process of “ensconcing new entrepreneurial groups in a promising sector,” and (3) the “full transformative job” in which “local firms . . . continually respond to global changes in technology and market.”\(^{37}\) These last two challenges correspond to our understanding of structural change and upgrading, a distinction David Waldner labels “Gerschenkronian” and “Kaldorian” respectively. The former connotes the collective dilemmas involved in “capital accumulation and its subsequent socially productive investment in new industrial enterprises.”\(^{38}\) The challenges of structural change involve both mobilizing scarce capital and deploying such assets “in productive assets in the face of tremendous risks.”\(^{39}\) Upgrading, on the other hand, involves efforts to improve productivity or innovate in new products by

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\(^{36}\) Rodrik (2003, 15–17).  
\(^{37}\) Evans (1995, 80). Static efficiency involves “finding optimal combinations of given resources and factors of production . . .” whereas dynamic efficiency typically involves mobilizing capacities and resources that are “hidden, scattered, or badly utilised,” (Hirschman 1958, 5). In this sense, structural change and upgrading are both instances of dynamic efficiency.  
\(^{38}\) Waldner (1999, 167).  
\(^{39}\) Ibid.
“making existing factories more efficient and … moving up the product cycle.”

Gary Gereffi adds an important global dimension by defining upgrading as “the process by which economic actors – nations, firms, and actors – move from low-value to relatively high value activities – in global production networks.”

I draw from these authors three components necessary for upgrading: (1) shifting from lower-value to higher-value economic activities in processes, products, functions, and/or sectors; (2) increasing inputs, both material and technological, from local, that is, “indigenous” firms; and (3) producing at levels of price, quality, and delivery demanded by global value chains. Despite operating in new sectors, such as steel, local firms may be unable to meet global requirements of price, quality, or delivery. Alternately, new, globally competitive sectors may be dominated by foreign producers operating largely in isolation from indigenous inputs. Neither of these scenarios – inefficient protectionism or denationalized, enclave-like
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competitiveness – involves the dynamic exports based on increasing local value added that characterize upgrading.

Upgrading, not structural change, distinguishes the East Asian NICs from the Southeast Asian “little tigers” or, as some have labeled them, the ASEAN-4: Indonesia, Malaysia, the Philippines, and Thailand.\textsuperscript{43} Table 1.1 shows that while the ASEAN-4 have not reached the levels of the NICs, they have made substantial progress in overall growth rates, the shift from agriculture to manufacturing, expansion and diversification of manufactured exports, and levels of medium–high-tech exports. But the two groups differ with regard to local linkages and local technological capacities. Foreign firms operating in the ASEAN-4 have moved into higher value-added products, but local producers account for little of this value. In contrast to South Korea, Taiwan, as well as Singapore, the ASEAN-4 economies tend to be dualistic, with foreign firms dominating high-tech exports as assemblers, exhibiting few linkages to domestic producers of intermediate and capital goods. This absence of linkages is reflected in the high trade deficits characteristic of mid- and high-tech industries throughout the ASEAN-4.\textsuperscript{44}

This lack of indigenous inputs is strikingly illustrated by Malaysia’s semiconductor industry. Although this industry has grown to become the second largest exporter of semiconductors to the United States,\textsuperscript{45} the industry “has remained relatively stuck at the same downstream stages of production as 25 years ago, still doing assembly, testing, and packaging for MNCs.”\textsuperscript{46} The high import content of Malaysia’s semiconductors is common throughout the country’s entire electrical and electronics industry, which, in the early 1990s, imported over 69% of intermediate inputs.\textsuperscript{47} Similarly, Thailand became one of the world’s largest exporters of hard disk drives in the 1980s and 1990s. But there are no significant Thai suppliers of parts or services to the foreign-owned disk drive producers. This contrasts with the significant development of local precision engineering and other suppliers to foreign firms seen in Singapore and, to an extent, Malaysia’s state of Penang.\textsuperscript{48}

There are also important ASEAN-4 vs. NIC differences with regard to local firms’ ability to shift from original equipment manufacturing (OEM)

\textsuperscript{43} ASEAN stands for Association of Southeast Asian Nations.
\textsuperscript{44} For example, Dhanani (2000); Chen (1999).
\textsuperscript{45} Chen (1999, 127).
\textsuperscript{46} Ibid. (127, 130).
\textsuperscript{47} Ibid. (134).
\textsuperscript{48} McKendrick, Haggard, and Doner (2000); Rasiah (2000).
### Table 1.1 Structural Changes in East Asia

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<td>35.06</td>
<td>26.59</td>
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<td>2.55</td>
<td>34</td>
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<td>10.4</td>
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<td>6.18</td>
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<td><strong>East Asian NICS Avg.</strong></td>
<td>6.79</td>
<td>25.23</td>
<td>22.79</td>
<td>13.97</td>
<td>1.91</td>
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<td>14.17</td>
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<td>31.92</td>
<td>10.46</td>
<td>70.8</td>
<td>52.1</td>
<td>19.7</td>
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<td>28.75</td>
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<td><strong>Avg.</strong></td>
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Sources: World Bank Development Indicators, 2001; Asian Development Bank Economic Indicators, various years.