THE POLITICAL ECONOMY OF EXPORT ORIENTED INDUSTRIALIZATION IN EAST ASIA: INDIGENOUS AND FOREIGN DIRECT INVESTMENT MODELS

by

Pieter Ellerd STEK

Major in International Cooperation

Graduate School of International Studies

Yonsei University

16 December 2010

THE POLITICAL ECONOMY OF EXPORT ORIENTED INDUSTRIALIZATION IN EAST ASIA: INDIGENOUS AND FOREIGN DIRECT INVESTMENT MODELS

by

Pieter Ellerd STEK

A thesis submitted to the faculty of

Yonsei University

in partial fulfillment of the requirements for the degree of

Master of International Studies

Major in International Cooperation

Graduate School of International Studies

Yonsei University, Seoul, Korea

16 December 2010

GRADUATE SCHOOL OF INTERNATIONAL STUDIES

YONSEI UNIVERSITY

COMMITTEE APPROVAL

of a master's thesis submitted by

Pieter Ellerd STEK

This thesis has been read by each member of the supervisory committee and by majority vote has been found to be satisfactory.

(date)____Prof. Sohn Yul (chair)

(date)____Prof. Lee Jeong Yeon

(date)____Prof. Michael Kim

ACKNOWLEDGEMENTS

I would like to thank my teachers and professors for challenging and inspiring me to always study more, both in Korea, The Netherlands and beyond. Thanks for advising me patiently, even though I can be rather stubborn at times. I am also indebted to my friends and family for showing interest in what I was doing and I apologize to them, and especially to my girlfriend, for having had to compete fiercely for my attention while I was writing this thesis. But its done now!

Thanks also to my parents as well, for dragging me across the world as a child. Having lived in countries like Malaysia, Nigeria and Syria has not only given me greater insight, but also a passion for learning about other places and a thorough enjoyment of meeting different kinds of people. Enjoy your retirement!

But a thesis completed and a degree (almost) earned, also means the end to a chapter of my life. I will remember fondly, along with many of my friends, the good nights spent in Sincheon or Hongdae or at my old boarding house near Yonsei's East Gate, cooking, drinking, talking. Those were the days. May good things happen to you all!

TABLE OF CONTENTS

ABSTRACT

A large part of the success of East Asian economies during the past the decades is attributed to export-oriented industrialization (EOI). However the role of government and FDI in the process of EOI varies considerably between East Asian economies. On one extreme is the indigenous industrialization model of the developmental states, especially Japan and South Korea, where the state has induced domestic advanced technology EOI. On the other extreme are three Southeast Asian economies, Hong Kong, Malaysia and Singapore, which are very successful economically and have also attracted a large amount of foreign direct investment (FDI), especially into their export-oriented manufacturing sectors. They have virtually no domestic advanced technology export-oriented manufacturers.

Although FDI in the manufacturing sector has merits and demerits, its large presence in the FDI-led EOI economies and virtual absence from the developmental states can also be attributed to radically different political economies. Using the structures of power method by Susan Strange (1994), the two models are compared and contrasted. The method identifies four dimensions of power: security, knowledge, production and finance.

In the developmental states domestic industrialization is favored for national security reasons

and because the economies are relatively isolated from the world economy with low amounts of foreign investment to begin with, both inward and outward. Governments maintain control over the finance and production structure through which they create a climate that allows domestic export oriented industries to develop.

In the three Southeast Asian economies, in contrast, FDI-led EOI is favored because there already is significant inward and outward FDI and there is neither a strong national security problem, nor strong nationalism which might justify such a program. Instead the government focuses on improving public services delivery and intervenes in the economy to increase its tax revenue without discouraging further FDI.

Therefore the economic legacy and domestic politics seem to be the main factors that determine the political economy of development. Furthermore, it is very difficult to change the structures of the political economy once they have been set, because there are many reinforcing feedback mechanisms. This suggests that significant economic policy changes do not occur without significant political changes, even though the existing political order may appear to have been preserved.

I. INTRODUCTION

The economic success of the East Asian economies during the past decades has largely been based on the export of manufactured goods. Although export competitiveness initially depended on low labor costs, the East Asian economies rapidly evolved into exporters of technology and capital intensive goods. In East Asia this process of Export-Oriented Industrialization (EOI) started in Japan during the nineteenth century and it was followed during the 1960s by South Korea, Taiwan, Hong Kong and Singapore, the so-called "Tiger Economies." By the 1970s Thailand, Malaysia, The Philippines and Indonesia also started EOI, while communist Vietnam and Mainland China started on the EOI path in the late 1980s.

An important prerequisite for East Asian EOI was access to the American market, which absorbed the vast majority of East Asian exports. Access to the American market served American Cold War geopolitical interests because it helped non-communist countries, both in Western Europe and East Asia, compete economically and militarily with the Soviet Union, Mainland China and their allies. Given the clearly positive economic effects from EOI, it is not surprising that East Asian economies followed such a policy.

Although the successful East Asian economies generally pursued EOI, there were significant differences in how EOI was pursued. In Japan, South Korea and Taiwan the export-oriented manufacturing sector largely consisted of indigenous companies. However in Southeast Asia, especially in Thailand, Malaysia and Singapore, the export-oriented manufacturing sector depended mainly on Foreign Direct Investment (FDI) and indigenous companies played only a very modest role in EOI. Most of this FDI came from Japan and the United States, with smaller amounts from Western Europe, South Korea, Taiwan and Hong Kong. (Hill, 1990)

The difference between FDI-led and indigenous industrialization lies primarily in ownership, and this ownership has political and economic consequences. From the economic perspective, FDI-led growth presents a dichotomy. On the one hand, FDI harms the development of indigenous industry because it is in direct competition with it. Indigenous industry has greater innovative capacity and therefore indigenous industries improve productivity growth in the long term by developing new technologies. (Chang, 1994) However FDI is also an important channel for the transfer of technology and capital from advanced economies to developing economies and in doing so it increases productivity growth in the short term. (Ozawa, 2005) The reason FDI has lower innovative capacity is because the technology is often developed in the FDI-sending country and therefore capital for innovation is not invested the FDI-receiving country, which can be seen as an economic loss.

Yet the political implications of FDI are even more profound. Through a pro-FDI policy a significant part of the domestic economy can be controlled by foreign actors who most likely enjoy a degree of political support from foreign governments and who have deep and extensive business relationships with other foreign economic actors such as banks, suppliers and buyers. Attracting FDI gives a country access to these networks, as well as to foreign capital and technology, but it also creates a dependence on them. (Numazaki, 1998) This means that the government is likely to have less control over foreign owned industries because their dependence on the host country, and those of their main business partners, is likely to be small. Indigenous industries are likely to have much deeper ties to the country, both in terms of business relationships and government influence.

Although the political and economic effects of FDI-led and indigenous EOI differ, both models have been used very successfully. Singapore, which has amongst the highest per capita income in East Asia (see table 1), was also one of the largest recipients of FDI in the region, especially in its export-oriented manufacturing sector, which still accounts for nearly 30% of the city state's economy and where more than 90% of its output is produced by FDI factories. On the other extreme lie South Korea and Japan, both Organization for Economic Co-operation and

Development (OECD) member countries, which received very little FDI and which instead developed indigenous companies. This were especially successful in electronics and automobile production and streets around the world are full of *Kia* and *Toyota* cars, while living rooms are filled with *LG* and *Sony* televisions.

The EOI in most countries involved FDI *and* indigenous companies. FDI-dependent Singapore produced *Creative*, a strong brand in computer sound cards and MP3 players. And although South Korea relied mainly on domestic companies for EOI, it also had some Japanese FDI in its electronics sector, especially in export processing zones in the south, which are geographically close to Japan. (Woo, 1993) But these exceptions do not take away from the fact that one of these models was dominant in either country.

I.1 Indigenous EOI

The typical indigenous EOI cases are South Korea and Japan. Although their EOI experiences are very different, with Japan starting in the nineteenth century while South Korea only really developed after 1960, they share many commonalities. The first of these is their "developmental state," (Johnson, 1982) which entails an extensive amount of coordination between the bureaucracy, banks and industries and has created agglomerated corporate structures such as the *chaebol* in South Korea and the *keiretsu* in Japan. In Japan these conglomerates tended to be anchored by a bank through cross-shareholdings. In South Korea family ownership and various cross-shareholdings ensured the coordination of these businesses groups.

Second, EOI was of great strategic importance. EOI not only stimulated economic growth, but it was also directed towards heavy industries to enable military production during wartime. Both countries maintained large conventional armies in response to the military threat posed by communist countries. The government's promotion of shipbuilding, automotive and steel industries in Japan during the 1930s and in South Korea during the 1970s must be seen in this light. (Horikane, 2005)

Third, Japan and South Korea had anti-FDI positions. In Japan, the militarization during the 1930s prohibited FDI in industries with strategic defense value. Although this position was changed after 1945 because of the American occupation and democratization, the coordinated market economy ensured that FDI continued to play only a small role. Hence foreign competitors were conveniently kept at a distance while Japanese companies expanded overseas. In South Korea, the entire stock of Japanese FDI was nationalized after 1945, and it was not until 1965 that diplomatic relations with Japan were restored. This break from Japanese FDI gave opportunities to domestic businesses and they continued to receive support after 1965.

Although South Korea was heavily dependent on foreign capital and technology to enable EOI, both loans and technology were mediated by the government, thus limiting foreign control over the manufacturing sector. This policy served all domestic constituents well, because it gave the government more power and the private sector less foreign competition on the domestic market.

Economy	**GDP (PPP)**	**GDP per capita (PPP)**
Japan	$4,159 bn	$32,554
South Korea	$1,364 bn	$27,938
Malaysia	$384 bn	$13,800
Hong Kong	$307 bn	$42,653
Singapore	$239 bn	$50,180

Table 1: Per capita income statistics of selected East Asian economies (Source: International Monetary Fund, 2009)

I.2 FDI-led EOI

The largest recipients of FDI in their manufacturing sectors from 1960 to 1990 were Hong Kong, Malaysia and Singapore. These economies also faced very different political circumstances relative to each other. Hong Kong remained a British crown colony until 1997, while Singapore and Malaysia split in 1965. After the split, Malaysia launched a highly interventionist affirmative action program in 1970 in an attempt to reduce the economic divide between its Malay and Chinese populations. In the 1980s it launched a heavy industrialization program with Japanese technological assistance, but this was ultimately unsuccessful. Yet in all three countries FDI-led model of EOI was dominant, which given their very different political situations, seems remarkable.

First, the relationship between government, banks and industry was much more market-based. This can first of all be explained by the large presence of foreign banks who are much more likely to make lending decisions on a commercial basis, rather than under political pressure. Hence funding indigenous infant industries, which are inherently risky was more difficult. Local banks, unless government owned, were unlikely to fill this void because of competitive pressures from the foreign banks. Furthermore, because FDI was not restricted, these indigenous industries, even when protected by import tariffs, still faced experienced foreign competitors, further diminishing their chances of success. In fact, both domestic and foreign banks were prepared to fund FDI projects. And domestic capitalists were satisfied with a minority share in export-oriented manufacturing companies, given that they used proven foreign technologies which reduced the investment risk.

Second, FDI-led EOI was seen as politically useful. Besides providing employment and foreign exchange earnings, it competed with domestic constituencies that were not particularly close to the government. In Malaysia small and medium-sized Chinese manufacturing firms were mainly in direct competition with FDI, however the government got its main political support from Malay voters and financial support from large Chinese capitalists who operated in protected sectors of the economy. Singapore's socialist oriented government did not rely on support from the domestic business community either, while in Hong Kong the colonial government raised most taxes from the sale of property and hence the manufacturing sector played only a minor role in political calculations. Nowhere was there a significant domestic constituency who would oppose FDI-led EOI, although especially in Malaysia and even in Singapore, FDI was restricted in other sectors of the economy, including land ownership.

Third, all three economies did not obstruct the outflow of domestic capital. This meant that geographical diversification became an attractive alternative to technological upgrading. A prime example of this is the textiles sector, which faced quotas from the late 1960s onwards. In South Korea this caused several textile producers to diversify into other products while Hong Kong based producers shifted their production abroad. Similarly, the openness to capital outflows allowed many domestic capitalists to accumulate assets abroad, often in mature Western markets, instead of investing in more risky indigenous EOI.

I.3 Theoretical issues

The activities of transnational corporations, the main source of FDI, have often posed theoretical problems for political economists. Transnational corporations are non-state actors and therefore do not fit in the traditional state-centered view of the international political economy or the domestic-centered view of the national political economy. To resolve this problem, Susan Strange (1994) argues that political economic questions are essentially questions of power, such as: “who gets the benefits and who pays? Who gets new opportunities to acquire wealth or power, security, or the freedom to choose? And who has imposed on them new risks of being denied these things?” These questions, she argues, can be posed at all levels of political economy, from the international system to a particular sector of the economy.

Strange identifies four dimensions of power which together provide a complete picture of the political economy. These dimensions are security, knowledge, production and financial power. Within these dimensions, strange distinguishes between relational and structural power, the former being the ability to influence others, and the latter being the ability to change the rules of the game itself. Because non-state actors often do wield significant relational and even structural power in all of these areas, they must be incorporated into political economic analysis. A state’s control over security can be compromised by organized crime, its control over knowledge by non-state media, its control over production by private ownership of the means of production, and its control over finance by commercial banks. All such factors must feature in political economic analysis.

In this thesis the structures of power method is applied to the indigenous and FDI-led EOI models. The purpose of this analysis is to compare and contrast the political economies of both models and understanding their robustness in the face of political and economic changes, both domestically and internationally. This analysis aims to support the argument that EOI is not merely an economic policy, but a political policy and that political rather than economic circumstances shape the EOI model that is chosen. The implications of this are that important economic shifts indicate profound political changes even though the previous political order may appear to have been left intact. At the same time, this suggests that economic reform is also impossible without political changes, which is something economic advisers from the various intergovernmental financial institutions should keep in mind.

To analyze the EOI models, in the next chapter Strange's (1994) structures of power method is described in further detail and its principles are applied to the questions of economic development. In chapter III the political economy of indigenous EOI is described according to the four dimensions of power, and in chapter IV the same is done for the political economy of FDI-led EOI. In the last chapter, chapter V, the political economies of both EOI models are compared and contrasted.

II. STRUCTURES OF POWER IN THE POLITICAL ECONOMY OF EOI

In this chapter Susan Strange's (1994) structures of power method will first be described in more detail. (Section II.1) Thereafter it will be developed further, with the aim of using it to analyze the political economy of EOI. (Section II.2)

II.1 Structures of power

The appeal of the structures of power method lies in its simplicity and flexibility. Instead of trying to approach political economic questions from different theoretical perspectives such as liberalism, realism or Marxism, Strange poses very simple questions about power: who holds it and why, when and how will they use it? She rightly criticizes the existing methods of teaching political economy, which she likens to giving students several competing theories and then asking them to pick one they happen to like. (Strange, 1994)

In all fairness, Strange's concept should be seen more as a method, rather than a theory. Just like the scientific method provides a way to test the limitations of Newton's Laws of Motion or Einstein's Theory of Relativity. This observation argues strongly in her favor because many theories in the social sciences become closely intertwined with political ideologies, and they thus lose their scientific value. Karl Popper (1963) describes how Marxism transformed from a theory into an ideology:

> In some of its earlier formulations (for example in Marx's analysis of the character of the 'coming social revolution') their predictions were testable, and in fact falsified. Yet instead of accepting the refutations the followers of Marx re-interpreted both the theory and the evidence in order to make them agree. In this way they rescued the theory form refutation; but they did so at the price of adopting a device which made it irrefutable. They thus gave a 'conventionalist twist' to the theory; and by this stratagem they destroyed its much advertised claim to scientific status.

The questioning approach of Strange, which Popper would have undoubtedly approved of, avoids the problem of irrefutability. If there is new evidence or better arguments, then obviously the answers to the questions will also change and so will out understanding of a particular political economy. Therefore the simplicity of her method is also its greatest strength.

The other advantage of Strange's method is its flexibility. It can be used to analyze any political economy, from a university to the international system, and the same questions can be asked: Does the professor have hegemony? Who decides how many research papers must be produced? Does the United States have hegemony? Who benefits from increased free trade?

To define the concept of power, Strange distinguishes between relational power and structural power and between four different dimensions of power: security, knowledge, production and finance. Structural power is essentially the ability to set the rules of the game. Herein she often referred to the market-authority nexus, where shifts of power take place between the state and market actors. Those who have structural power also automatically have significant relational power, but the opposite is not true. Relational power is the ability to influence other actors, but this power can only be exercised within the existing power structure. Therefore structural power is most important.

To make an analogy, consider a professor who teaches a mandatory course and sets the exam. Students can choose not to study for the exam and fail. Or students can study and use relational power with upperclassmen or the professor to try and find out what will be on the exam. But the professor holds structural power because he makes the exam and it is a mandatory course. The student can only choose if he wants to study and pass the exam, or fail and retake it later.

Regardless of its nature, power is rarely exercised in just one field. American military strength has a lot to do with its economic strength. Germany's low military profile, despite its large economy, is closely connected with how that country views its wartime pasts. Strange therefore distinguishes between four dimensions of power: security, knowledge, financial and production. These dimensions together form a whole, a complete picture of power within a particular political economy.

The security structure is “the framework of power created by the provision of security by some human beings for others.” (Strange, 1994) Although this role is usually fulfilled by the state, it can also be provided by private actors such as private security companies, rebel armies or organized criminal organizations.

The knowledge structure “comprehends what is believed; what is known and perceived as understood; and the channels by which beliefs, ideas and knowledge are communicated.” (Strange, 1994) Censorship plays an important role on controlling the knowledge structure but so do shared historical experiences or beliefs. Nationalism is a particularly strong example of state-control over the knowledge structure while religion or opposing political ideologies can weaken this control.

The production structure is “the sum of all arrangements determining what is produced, by whom and for whom, by what method and on what terms.” (Strange, 1994) In planned economies such as North Korea, these decisions lie largely with the state while in market economies private producers and consumers play an important role and profit is an important motivator.

The financial structure is the “sum of all arrangements covering the availability of credit plus all the factors determining the terms on which currencies are exchanged for one another." (Strange, 1994) Since the collapse of the Bretton Woods system of fixed exchange rates in 1985, financial power has largely shifted from the state to the market, where banks and investment funds are the decision makers.

Thus Strange's method is simple and flexible and it is therefore suitable for carrying out analyses on a wide range of political economic questions, including the political economy of development.

II.2 Power in the political economy of EOI

Many of the theories concerning the political economy of development, of which EOI is an important part, intersect with Strange's dimensions of power. The problem is that many theories do not extend to all four dimensions of power or they are limited to certain political economic relationships, such as those between states or between only rival groups within a society, ignoring the influence of other groups, domestic non-state actors and international actors.

Rather than attempting to summarize all the literature on the political economy of development, the most prominent discussions for each dimension of power are highlighted. The purpose of this exercise is to establish a theoretical basis for analyzing the indigenous and FDI-led EOI models.

The provision of security is an important factor in the political economy of development because, according to Hall and Jones (1999):

> ...productive activities are vulnerable to predation. If a farm cannot be protected from theft, then thievery will be an attractive alternative to farming. A fraction of the labor force will be employed as thieves, making no contribution to output. Farmers will spend more of their time protecting their farms from thieves and consequently grow fewer crops per hour of effort.

The lack of security, for instance the lack of private property protection, is therefore often perceived as an obstacle to economic development. When security is not provided by the state but by other actors, the accumulation of capital or the provision of credit (which are needed for modern industry to develop) can become much more difficult.

Yet even if the state is capable of providing security, it may not do so for political reasons. Governments can nationalize productive assets without proper compensation, and the threat of this deters (foreign) investment. The threat of war can also lead investors to avoid investing in a country because they fear that their assets will be physically damaged or expropriated.

The impact of the state's actions in the security structure depends on its influence in other areas.

For example, if the state restricts international capital flows, domestically accumulated capital may still be invested in the domestic economy despite a security threat because domestic investors have fewer alternatives.

The knowledge structure is essentially about what the general population and the elite believe to be true. Cultural explanations for economic development, such as Asian Values during the 1990s, are problematic because of their irrefutability, as pointed out earlier in this chapter. These theories surface after economic development has already started and they conveniently forget to ask why, if the culture already existed, it took so long for economic development to finally take off. Catholic, (e.g. Weber, 1958) non-Western, Confucian and Muslim culture were all once thought to be incompatible with economic growth; that is until Italy, Japan, South Korea and Turkey became modern industrial economies. This is not to deny the importance of culture and belief systems, it is rather to emphasize that they are dynamic.

Relevant to the political economy of development are beliefs and behavior that is economically beneficial, such as saving money (rather than spending everything) and working hard (rather than trying to cheat others). These values are essentially middle class values and thus the growth of the middle class is an important sign of economic development. (Easterly, 2001) Yet also important are older beliefs and expectations, for example those about nation, race or religion. These beliefs can be used to unite the people behind the state and give legitimacy to its economic policies, but beliefs can also divide a country and turn people against the state. Decolonization too, it can be argued, was much more prominently fought in the ideological arena than it was in any other. The colonial system lost its legitimacy not just in the eyes of the colonized peoples, the United States and the Soviet Union, but also in the eyes of the colonizers, many of whom were no longer prepared to defend what they regarded as a morally bankrupt system. (Ferguson, 2004)

While the security and knowledge structures are relatively recent phenomena in studies on the political economy of development, the production and financial structure have a much longer history. Most prominent amongst these theories is probably dependency theory which explains the unequal economic relationship between the "core" (developed countries) and the "periphery" (developing countries, especially those in Latin America), who lose out. (Cardoso and Faletto, 1979)

The basis of this theory is the observation that the core tends to export industrial goods to the periphery, while the periphery exports raw materials to the core. Only the core is able to produce industrial goods because only it has the needed capital and technology and the periphery does not. But because the profits from industrial goods are much higher than from raw materials, there is an “unequal exchange” between the core and the periphery. Free trade, patent laws and an international banking cartel ensure that no indigenous industries can develop in the periphery and that it remains dependent on the core.

Although EOI in peripheral East Asian economies contradicts dependency theory, foreign consumers, investors and bankers do hold significant power over almost every developing economy’s production and financial structure. Because developing countries often have small domestic markets, they depend on exports to larger foreign markets. Because their capital stock is low, they rely on foreign loans and investment to develop their economies. These foreign parties are usually profit-oriented and they will therefore act on a commercial basis. Therefore developing countries are under pressure to offer low prices and profitable business opportunities, or they will be unable to export their goods or attract foreign capital.

This does not mean that developing countries are powerless. Governments can impose foreign exchange controls, limit or regulate foreign investment, impose import tariffs or provide tax incentives, subsidies and preferential loans. They can nationalize and buy out foreign shareholders, etc. Many developing countries also have natural resources, which if developed wisely, can give them significant financial resources to finance their development.

Given all the examples above, Strange's method seems very suitable for analyzing the political economy of development. In contrast to most other theories in the field, her method directs more attention to the knowledge structure, whose analysis may well offer new insights into the political economy of development.

III. POLITICAL ECONOMY OF INDIGENOES EOI: JAPAN AND SOUTH KOREA

The indigenous EOI model pursued by Japan and South Korea is almost synonymous with the political economy of the developmental state. The developmental state refers to a set of shared characteristics between the political economy of Japan from the 1950s to the 1970s and the political economy of South Korea from the 1960s to the 1980s. The phrase “developmental state” was coined by Johnson (1982) to describe Japan’s political economy, which differed significantly from those of other advanced capitalist economies. By 1982 Japan had recorded consistently high economic growth rates for more than three decades. The model was later expanded to South Korea, a former Japanese colony, by Amsden (1989) who noted that economy’s successful “late industrialization” and how the South Korean government enabled the development of a competitive indigenous export oriented manufacturing sector.

Relying primarily on these interpretations, supplemented by relevant literature when necessary, Strange’s method is applied to the developmental state. The security structure is discussed first (section III.1), followed by the knowledge structure (section III.2), production structure (section III.3) and the financial structure (section III.4).

III.1 Security structure

The role of the security structure in the political economy of the developmental states primarily pertains to the Cold War. The threat from communist countries such as the Soviet Union, North Korea and Mainland China was indirectly beneficial to the economy because it guaranteed economic support from the United States. The United States provided the markets that enabled EOI while providing direct and indirect financial support, especially to South Korea, in the form of direct aid and the implicit backing of the American government to lending by American commercial banks.

But the security structure has a different level of impact when the government tightly controls the financial structure: capital flight becomes more difficult and therefore threats from North Korea or domestic political turmoil have less of an impact on the domestic economy than they would otherwise have. It was possible to impose these restrictions on the movement of capital because of the way in which Japan and South Korea structured their dependence on foreign capital. Japan simply avoided foreign capital all together, relying instead on domestic savings and in South Korea the government was the main borrower, thus eliminating many of the political risks. Furthermore, the South Korean government, and the American banks that financed it, also enjoyed the implicit financial backing of the American government, which supported it economically and militarily. (Woo, 1993)

So because of the structure of the political economy of the developmental state as a whole, the economic impact of any security problems, real or perceived, was lowered. Whether intentional or not, this arrangement undoubtedly helped to further stabilize the political economy of the developmental states.

III.2 Knowledge structure

The political origins of Japanese and South Korean industrialization lie in a struggle for national survival and a desire for economic and military independence. In the case of Japan this policy dates back to the Meiji Restoration in 1868 when political power was centralized, a series of drastic administrative reforms, and a program of rapid industrialization were undertaken. All this was done under the banner of building a "rich country, strong military." This doctrine of placing the Japanese national interest first in economic policymaking survived the American occupation of Japan from 1945 to 1952. Many prominent bureaucrats and businessmen from the pre-war period continued to hold important positions in the post-war Japanese establishment. (Johnson, 1982; Kelly, 2002)

South Korea's industrialization was also driven by a threat to national survival, specifically the need to compete militarily with North Korea. For this reason the government created heavy industries, such as the Pohang Iron and Steel Company and supported private investment in heavy industries. Investment in heavy industry was accelerated during the late 1960s in response to increased North Korean aggression, the American defeat in Vietnam and the establishment of diplomatic ties between the United States and Mainland China. South Korea viewed all these developments as threats to its national security. (Horikane, 2005)

In both South Korea and Japan industrial policy was not only aimed at creating domestic production capacity but also at attaining technological independence. The reasons for this are also tied to national security. For example, Japan and South Korea both protected their automotive industries so they could domestically produce armored vehicles. (Johnson, 1982; Woo, 1993) Hyundai and Mitsubishi are both major producers of trucks and passenger cars. And they also manufacture battle tanks. Hence there were clear non-commercial motives behind the industrial policies of the developmental state. The importance placed on national security in particular, and economic independence in general, explains a negative attitude towards FDI. In the case of South Korea, a fear of being subjugated by the Japanese production structure as had been the case before the war delayed the restoration of diplomatic ties with Japan until 1965. (Woo, 1993; Kim, 1997)

Because the Japanese and South Korean governments were politically conservative they tended to favor big business, depending on their political contributions, and depended on economic growth to maintain popular support. For example, Japanese Prime Minister Hayato Ikeda diffused Japan's tense political climate in the early 1960s with his "income doubling plan." Its strong economic record continued to be a key factor in keeping the Liberal Democratic Party in power in Japan until 1976, when it briefly lost power following a political scandal. (Pempel, 1982) In South Korea, President Park Chung-hee used his economic record to legitimize and distract attention from his oppressive regime, persistent student protests and labor unrest. (Kim, 1997)

Thus, the knowledge structure in the developmental state is headed by nationalistic elite which claims political legitimacy based on strong *national* economic performance. By claiming political victories on nationalist and economic grounds, criticism of areas where the government's record is less exemplary, such as corruption or the oppression of organized labor, is deflected. But as a consequence nationalism and economic growth become important social values. The waving of corruption and tax evasion charges against important business people from the Samsung Group in 2009 and 2010 illustrates this point. The South Korean president pardoned the men, arguing that their release served the national economic interest. (*Bloomberg*, 13 Aug 2010)

III.3 Production structure

The developmental states were highly dependent on the American market to sell their exports, although their initial economic development was helped by American military procurements. Japan benefited from the Korean War during the 1950s and South Korea and Japan both benefited from the Vietnam War during the 1960s. Thereafter the United States opened its markets to Japanese and South Korean exports which by the 1970s had become so successful that the United States forced both countries to impose export restraints, limiting their access to the American market. (Johnson, 1987; Woo, 1993; Numasaki, 1998)

An export driven manufacturing sector was combined with a relatively closed domestic market. This allowed companies to export at low prices to raise the needed foreign currency to buy machinery. But in the domestic market it was possible to sell the same goods at higher prices because competition from imports was restricted. Other measures included countertrade policies whereby companies had to generate a certain amount of exports to be given the foreign currency to import highly profitable consumer goods for sale on the domestic market. (Woo, 1993; Kim, 1997) In this way the export of manufactured goods was strongly encouraged while domestic consumption was suppressed as a result of relatively low salaries.

The governments tried to limit imports to necessary machinery and the purchase of foreign technology through licensing. Here, the government played an important role not only in targeting certain industries for development through preferential loans, but also by negotiating with foreign companies on domestic companies' behalf. (Johnson, 1987; Woo, 1993) Because the government coordinated industrialization, backward and forward linkages, infrastructure and other support could be planned, thus reducing the risks and sharing the cost of setting up new industries. (Chang, 1994) As a result many companies closely followed the government's lead in industrialization and these companies were rewarded with high profits. However many companies who did not invest in government-promoted sectors also benefited, taking advantage of more general incentives to setting up export oriented manufacturing industries. (Pempel, 1982; Kim, 1997)

Government intervention in the economy was not without corruption. But political patronage was handed out through domestically-oriented ministries such as the ministries dealing with construction, agriculture, telecommunications and tobacco. The ministries concerned with trade, industry and finance were less corrupt and had significantly better paid bureaucrats.

(Cheng et al., 1995) Hence there was a “bifurcation” in the bureaucracy that managed the economy. This division matched the general division between a highly competitive externally oriented manufacturing sector and a protected and often uncompetitive domestic sector. (Johnson, 1987)

In summary, a mix of government guidance and demand from export markets influenced production in the developmental state. Domestic demand was initially suppressed to enable high investment rates and by keeping salaries low relative to labor productivity.

III.4 Financial structure

The developmental states retained tight control over the banking system through a combination of regulation, state participation and foreign exchange controls. By doing so the state had significant influence over lending decisions.

By regulating interest rates and the number of bank branches, the state was able to exert influence over banks lending decisions. It could reward or punish banks for their willingness or unwillingness to extend credit on favorable terms to certain companies whose development the government considered to be strategic. This made bank credit one of the main sources of financing, including for the manufacturing sector. Furthermore, the government participated in the banking sector itself. In Japan, the government operated a large postal savings bank whose savings it could direct. (Johnson, 1982) In South Korea the government played an important role by borrowing from foreign banks and lending these funds to strategic domestic industries. (Woo, 1993) Hence the government could directly and indirectly exert significant influence over bank lending, giving it leverage over the loan-dependent production structure.

The government could not have regulated the financial structure to such an extent without foreign exchange and capital controls. These controls were necessary to ensure resident companies and individuals could not carry out transactions with foreign banks or participate in foreign financial markets without government approval. If this had been allowed, residents could have deposited their money abroad and received higher interest rates. Successful domestic companies could probably also have borrowed more cheaply abroad. This "leakage" from the financial system would have made it much more difficult for domestic banks to attract deposits and to continue providing loans to strategic companies at what were effectively subsidized interest rates.

The need for foreign exchange controls became clear about a decade after the developmental state had started to be dismantled when Japan and South Korea faced financial crises in 1991 and 1997 respectively. In the case of Japan, large domestic companies had been allowed to borrow funds from abroad and so domestic banks had lost some of their best clients. To compensate for this loss and because they still had access to a large pool of savings, they redirected lending to property investments, creating Japan's bubble economy from 1986 to 1991. (Anchurdogy, 2005) In the case of South Korea, financial liberalization led to a currency mismatch, because domestic banks borrowed short-term in foreign currencies to take advantage of their low interest rates. The banks then lent out these funds in the domestic currency at high interest rates. When the exchange rate moved against the banks, they suffered serious losses. In January 1998 the South Korean government shut down one third of all the country's commercial banks.

IV. POLITICAL ECONOMY OF FDI-LED EOI:

HONG KONG, MALAYSIA AND SINGAPORE

The political economy of FDI-let EOI is a set of commonalities between East Asia's most successful economies that attracted a lot of FDI. These economies are Hong Kong, Malaysia and Singapore, all former British colonies with significant Chinese immigrant populations, with a long tradition of liberal economic management and significant FDI. In fact, some foreign investors have such a long history and played such a prominent role in these economies that distinguishing them as 'foreign' seems odd. Many of these 'foreign' companies also have major, or sometimes controlling, local shareholders. (Hill, 1990; Studwell, 2007)

In this chapter the political economy of FDI-led EOI is analyzed using Strange's method. The analysis is carried out in the same order as in the previous chapter, starting with the security structure (section IV.1) followed by the knowledge structure (section IV.2), production structure (section IV.3) and the financial structure (section IV.4).

IV.1 Security structure

All three FDI-led EOI economies also faced security problems in the context of the Cold War, especially during the 1960s. Singapore and Malaysia faced inter-ethnic and communist unrest, while Hong Kong was hit by riots inspired by political events in Mainland China. In both cases this caused a decline in foreign investment, but investment flows resumed once the situation returned to normal. Part of the explanation for the relatively mild decline in FDI can be explained by the fact that the 1950s and 1960s were marked by strong economic growth. Europe was recovering from the Second World War and the Korean War and Vietnam War ensured additional demand for these economies' exports. (Jomo and Gomez, 1999) In the FDI-led EOI economies, American markets and FDI played an important role, both of which were encouraged as a way of supporting anti-communist economies during the Cold War, although American government aid was very limited.

As the political situation stabilized in the 1970s, security concerns took a back seat even though there was occasional political instability. Concerns over Hong Kong's return to China during the 1980s undoubtedly raised some concerns, as did a power struggle between factions of the ruling party in Malaysia during the early 1980s and again in the late 1990s. The reason that this political uncertainty never significantly affected the economy was because the issues did not affect economic policy and those involved in them did their utmost to put investors at ease. In the case of Hong Kong this meant assurances by Mainland China about Hong Kong's capitalist system until 2047. In Malaysia the FDI led manufacturing sector was consistently encouraged and supported by all significant political groups. (Jomo and Gomez, 1999)

IV.2 Knowledge structure

Hong Kong, Malaysia and Singapore all have weak national identities because of strong cultural and historical ties to neighboring countries (China, Indonesia and India), large immigrant populations and the fact that they were essentially recent colonial creations and not gradually formed nation states. Singapore and Hong Kong were founded by the British in 1819 and 1842 respectively. Malaysia was created in 1948 and 1963 as a federation by amalgamating different British colonial possessions which were not viable as independent states. Until the 1960s the formal colonial masters were the main foreign investors in the FDI-led EOI states, thereafter investors from outside the Commonwealth accounted for the largest share of FDI.

Adding to this complexity is the presence of a large Chinese population (the majority in Singapore and Hong Kong, the largest minority in Malaysia). In Malaysia and Singapore these migrants arrived mostly during the early twentieth century, while significant Chinese migration to Singapore and Hong Kong continues to this day. These “Overseas Chinese” control a disproportionately large share of the economy in many Southeast Asian countries even though the Chinese are an ethnic minority there. Many Overseas Chinese businesses also operate in several different Southeast Asian countries, where their investments are officially classified as

FDI. (Hill, 1990; Studwell, 2007)

These economic realities shaped the economic policies in the FDI-led EOI economies, during colonial times (which in Hong Kong lasted until 1997) and thereafter. Their governments sought to support or persuade rather than coerce local and foreign capitalists, hardly distinguishing between the two. Governments counted on the capitalists to deliver economic growth and jobs, while taxing them to finance steadily increasing public services. In Hong Kong and Singapore public housing and improvements in the education system and health service contributed to the governments' legitimacy and popularity. (Deyo 1981; Cheung, 2000) In Malaysia the government instituted the New Economic Policy in 1970, an affirmative action program in favor of indigenous Malaysians, called *bumiputras*. This policy was aimed at maintaining the government's legitimacy with the country's relatively poor Malay majority. (Jomo and Gomez, 1999)

Comparing the public service programs of Singapore and Hong Kong to the much more comprehensive New Economic Policy may seem like a stretch, but they had broadly similar aims: maintaining the government's legitimacy in the eyes of the majority of the population. This was important in Singapore and Malaysia because they were democracies, and rising living standards led to electoral victories. But in Hong Kong, because it was the world's last major colony, the British colonial government's legitimacy depended on governing well, which was in not only in the interest of the United Kingdom, Mainland China and the United States.

The FDI-led EOI states implemented these public programs in a way that avoided damaging key foreign and domestic business interests. Hong Kong achieved this by relying mainly on large domestic businesses to pay taxes and in turn it rewarded them by granting certain monopolies and giving them access to land, a precious commodity in the land-scarce territory. (Pritchard, 2006) In Singapore the government became a participant in almost all sectors of the economy, but as a commercial player, not as a monopolist. The government became a strategic investor in several foreign industries that set up factories there. It also created new state owned enterprises through which the government became the owner of the country's largest property developer, investment fund, domestic savings bank, public transport operator, telephone operator, airline, broadcaster, stock exchange, etc. In this way the government increased its participation in the economy, without increasing regulation of the economy. (Lim, 1983) Malaysia's New Economic Policy involved buying out foreign companies and selling them to bumiputra shareholders (Yacob and White, 2010), giving contracts to bumiputra businessmen and setting up new bumiputra companies. But the government also gave contracts to favored Chinese and Indian businessmen. Furthermore, the wealth transfer to bumiputras was largely financed by taxing natural resource rents. Because of this, the government was able to maintain investment in infrastructure and public services while taxes on all businesses were equal, regardless of who owned them. (Jomo and Gomez, 1999) So like Hong Kong and Singapore, the Malaysian government was able to retain its legitimacy through government spending, while balancing this with the interest of domestic and foreign capital, enabling it to maintain strong economic growth.

Therefore the perception held by government of local and foreign capitalists in the FDI-led EOI states was primarily as a source of employment and taxes. The governments were liberal in the sense that they allowed the free flow of goods and capital in a belief that this benefited the economy. However they were interventionist in the sense that they were willing to not just provide public services, but also to create and tax certain monopolies (especially in Hong Kong) or setting up government-run companies to manage important natural resources such as property (Singapore) or petroleum (Malaysia) to raise funds.

IV.3 Production structure

The FDI-led EOI economies were dependent on foreign markets, but to penetrate these markets they relied on attracting FDI instead of nurturing indigenous enterprises. This was especially true in more technologically advanced sectors such as chemicals and electronics manufacturing. (Numazaki, 1998) By late 1988 more than 90% of Singapore's exports were produced by FDI companies. In Malaysia 35% of exports were from FDI companies. The share of exports from FDI companies in Hong Kong was significantly lower, but this can be explained by the small size of the manufacturing sector in the British colony. (Hill, 1990)

All three economies relied on the American market to sell the majority of their exports, but FDI also created a second dependency on foreign technology. In Malaysia and Singapore an increase in exports to the United States led to an increase in imports of high technology components from Japan. (Numazaki, 1998) The dominance of FDI in the manufacturing sector pushed domestic capital into other sectors such as property development, banking and retail and into lower technology manufacturing such as toys and textiles. (Kunio, 1988) Textiles played a particularly important role in the early industrialization of Hong Kong, but instead of technological upgrading Hong Kong textile producers moved production offshore, including to Singapore and Malaysia, but after 1978 most production was shifted to Mainland China. (Gereffi, 1998)

The concentration of domestic capital in property development, banking, retailing and lower technology manufacturing can largely be explained by the commercial basis on which capital was allocated. Statistics from Singapore show that of all export-oriented manufacturing investment between 1960 and 1978, American, European and Japanese invested projects had a failure rate of 6% and companies from Hong Kong and Taiwan had a failure rate of 17%. In contrast, domestic (Singapore) investments in export oriented manufacturing had a failure rate of 38%. Because of these higher risks banks were reluctant to finance domestic companies' export-oriented manufacturing ventures. Instead they allocated funds to lower risk projects which had collateral (e.g. property development) or on which local companies tended to have an edge (e.g. retailing) or in manufacturing if the local companies had a foreign joint venture partner or licensed proven foreign technology. (Chia, 1985)

The important high technology export-oriented manufacturing sector thus became dominated by FDI, diverting domestic capital to other sectors or to make investments abroad. These foreign investments were in assets rather than in technology. Hence many large businesses from the three FDI-led EOI economies invested in property and infrastructure companies in mature Western markets or in emerging markets such as Mainland China and Southeast Asia. Others have bought stakes in existing foreign companies. For example, the late Khoo Teck Puat, a Malaysian-born businessman, bought a 15% stake in the London-based Standard Chartered

Bank during the 1980s. This turned out to be his best-ever business decision, and the rise in the British banks' share price turned him from a millionaire into a billionaire by the time of his death in 2004. (Studwell, 2007)

IV.4 Financial structure

The financial structure of the FDI-led EOI economies is mainly controlled by the private sector, although government owned banks did play a minor role in the economy. Hence credit allocation occurred mostly on a commercial basis. The governments also maintained freely exchangeable currencies, although during crises these governments intervened to protect their relatively small domestic financial markets. (Lee, 1990; Cheung 2000)

The main government owned banks in the FDI-led EOI economies were the Bank of China in Hong Kong, Bank Bumiputra in Malaysia and the Development Bank of Singapore. The Bank of China was owned by the government of Mainland China and its purpose was to facilitate financial transactions between Hong Kong and the Mainland therefore its influence on the local Hong Kong economy was limited. Bank Bumiputra was created to assist bumiputra entrepreneurs, but because of poor financial management its impact on the Malaysian economy was relatively small. The bank had to be bailed out on several occasions because of unauthorized losses or poor investment decisions. (Jomo and Gomez, 1999) The Development Bank of

Singapore became the country's biggest bank, but it acted largely on a commercial basis, financing both private sector and government projects. (Lee, 1990) Thus the extent of government influence on the banking sector was relatively small, even though governments owned financial institutions.

The liberal financial system attracted a significant number of foreign players, with each financial center serving a different niche. Hong Kong played an important role in financing the rapid economic development of Mainland China. For example, many of the Mainland's most successful private companies, such as Haier electronics and Lenovo computers, were financed through Hong Kong. Hong Kong was also used by the Chinese government to list shares in large state-owned companies. (Huang, 2008) Singapore developed itself into a financial center that serves Southeast Asia and it is also an important currency trading center. (Numazaki, 1998) And the Malaysian capital Kuala Lumpur has recently become a significant regional center for Islamic finance, attracting banks from the Middle East.

The liberal financial system has also made it easier for domestic companies and banks to carry out transactions abroad. Several banks from Hong Kong, Malaysia and Singapore have invested in the financial sector of neighboring countries and all three economies have generated significant outward FDI.

However a large part of the attractiveness of the FDI-led EOI economies as financial centers comes from the fact that they are well regulated. This point was put to the test during the 1997 financial crisis when Malaysia imposed currency controls to stop the short selling of its currency. In Hong Kong, the financial secretary briefly raised the overnight interest rate to a very high rate and started to use government reserves to buy shares in the blue chip Hang Seng stock index. These actions broke the backs of speculators and restores stability in the Hong Kong financial markets. (Jomo and Gomez, 1997; Cheung, 2000) Singapore faced fewer problems during the 1997 crisis but evidence from the past showed that it was also prepared to crack down on fraudulent financial practices. (Lee, 1990)

So although the FDI-led EOI economies have a very open financial structure which leaves most financial decisions to the private sector, their governments have been willing and able to act independently when their financial stability became threatened. They did this without assistance from the International Monetary Fund, thus consistently maintaining sovereignty over their financial structure.

V. COMPARISON AND CONCLUSION

The analysis of the political economies of the indigenous and the FDI-led EOI models, have shown a strong divergence on many fundamental issues, especially related to the methods of government control over the economy. In this final chapter the two models are compared in order to better understand the way in which each of them operates. This comparison is done according to the four dimensions of power and in the following order: the production structure (section V.1), the financial structure (section V.2) and the security structure (section V.3) are analyzed followed by the knowledge structure (section V.4).

The outcome of this comparison is summarized in the conclusion (section V.5), where it is argued that the continuation of the colonial economic system after 1945 can largely explain the persistence of a FDI-led EOI in Hong Kong, Malaysia and Singapore even though there were changes in the political system. The indigenous EOI of South Korea in particular can be explained by a combination of political factors, including the example set by and fear of competition from Japan, whereas Japan in many ways maintained its prewar status quo. In all cases EOI was an important part of wider Cold War strategic considerations.

V.1 Production structure

The main difference between the production structure between the indigenous and FDI-led EOI models is that the developmental state nurtured indigenous and high technology export oriented manufacturing companies. These dominate the economy in the developmental state and are almost completely absent in the FDI-led EOI economies.

The absence can be explained by FDI, which is usually much more competitive than new indigenous firms, and thus its presence prevents these firms' development. In the developmental state foreign competition is restricted to the largest possible extent while the necessary foreign capital is attracted through loans and technology is gained through licensing agreements. This protection gives inexperienced indigenous industries a chance to develop before they begin to compete with more experienced foreign competitors.

But it is important to note that these indigenous manufacturers export a significant share of their production. This is partly driven by a need to earn foreign exchange to repay foreign loans but it also exposes them to the more beneficial effects of competition, including pressure to innovate and lower costs. Such an industrial environment can only be created through government intervention; it does not exist in a free market, but neither does it exist in a completely protected market.

The governments in the FDI-led EOI economies did not want to or were unable to carry out such interventions. In the case of Hong Kong, the colonial government did not feel that it should have an industrial policy while in Singapore the government essentially forged an alliance with FDI, becoming a joint venture partner and providing loans and other benefits to FDI projects. In Malaysia the government's main focus was on increasing the *bumiputra* share in the economy with FDI being perceived as a useful source of employment and export earnings rather than a threat to its economic modernization policies.

Because they were more economically developed and because the stock of FDI was already large, the economic and political costs of severely restricting FDI would have been very high in Hong Kong, Malaysia and Singapore. Many domestic constituencies also benefited from FDI because it provided them with jobs and domestic capitalists were often invested abroad themselves. Therefore if trade and investment were suddenly restricted, the economy would have suffered. A gradual restriction on FDI would have also led to capital flight and a decline in investment. Therefore maintaining the colonial FDI policies, albeit with some modifications, was a very logical course of action.

In the developmental states the cost of going against FDI was negligible because there was hardly any FDI to begin with. South Korea nationalized most Japanese FDI at the end of the Second World War and hence the South Koreans could start from scratch. The Japanese had limited FDI for national security reasons before 1945 and they maintained this policy after 1945 even though the national security situation had changed. Thus they laid the foundations for the development of indigenous industries.

V.2 Financial structure

Control over the financial structure was crucially important to exert control over the production structure, and vice versa. Control over the financial structure allowed the developmental states to direct loans to indigenous export oriented industries while a protectionist trade regime ensured that these investments were profitable. One could not succeed without the other.

Probably equally important was that domestic capital was largely captive in the developmental state and could not flow abroad in search of higher returns. Various government measures also encouraged savings and these funds could be directed by the government using its influence as the regulator and owner of banks.

In the FDI-led EOI economies banks operated in a much more international environment, thus making it impossible for governments to exert as much influence. Therefore banks made commercial lending decisions which meant that they were not prepared to finance risky investments by domestic enterprises in export oriented manufacturing industries, a crucial difference between their competitors in the developmental states. Furthermore, successful domestic entrepreneurs were able to invest abroad. Therefore instead of trying to create new industries at home, they chose to expand abroad. Again, they took a relatively low risk attitude and ventured into property development, finance, retailing and low technology manufacturing.

Hence the lack of investment in indigenous manufacturing industries in the FDI-led EOI economies is a perfectly rational business response. Similarly, investment in these same sectors in the developmental states was also very rational because of the government's support.

V.3 Security structure

Besides the enabling strategic environment that the Cold War provided for EOI, the security structure is mainly defined as political risks to domestic and foreign investment. Security issues did not play a very important role in the developmental state, nor in the FDI-led EOI economies. This was primarily because of favorable economic circumstances during periods of political instability in the 1950s and 1960s, which limited capital flight from the FDI-led EOI economies. In the developmental states, capital flight was altogether less significant because of financial restrictions that prevented it.

But external security did play a significant role in the political economy of the developmental states, especially in South Korea where it became the main justifications for its chemical and heavy industrial expansion program. External security was much less prominent in the FDI-led EOI economies and it could not used to justify a heavy industrial policy. The FDI-led EOI economies relied on a foreign security structure for their protection. Malaysia was supported by British and Commonwealth forces to oppress its communist insurgency during the 1950s and 1960s while Hong Kong and Singapore depended on the presence of British forces, although force numbers were drawn down during the late 1960s and early 1970s. Since the 1990s, Singapore has hosted American naval facilities.

V.4 Knowledge structure

In the FDI-led EOI economies a strong policy to control the production and financial structures in favor of the FDI led status quo was politically unviable. These policies clashed with the interests of the existing capitalist class, many of whom were foreigners or who invested abroad, and there was no strong ideological argument that justified the potentially disruptive impact of implementing such a policy.

In contrast, in the control over the financial and production structure imposed by the developmental states created many lucrative business opportunities for local capitalists, who were therefore inclined to support these policies. Furthermore, there was no vested interest from existing FDI or transnational domestic investors to oppose these controls. Because the developmental states were much more cohesive nation states with few ethnic or linguistic differences and without the contradictions that the colonial system had imposed on them, they could argue in favor of these policies on nationalist grounds. In Malaysia, Singapore and Hong Kong such a national identity was far less well developed.

The domestic capitalists in the developmental states were also far easier to control because their business success depended on state support. Only when domestic companies matured and became internationally competitive without state support, did they start to slip out of the state's control and invest increasingly abroad. This point essentially marked the end of the developmental state.

But it is important to note that in both political economies, the governments' legitimacy depended on delivering economic growth, something which they managed to do very well. As long as the economy kept growing and the government expanded public services, most other political issues were of secondary importance. In both political economies the government relied on the private sector to deliver this growth, the main difference being that in the FDI-led EOI economies the private sector had far more foreign participation, which limited the extent of government control.

V.5 Conclusion

The FDI-led EOI economies essentially continued on the path set by colonialism, which was a *laissez faire* economic policy which attracted significant FDI. Because of their weak national identities and the success and transnational nature of their colonial economic structures, there were no strong political reasons to make radical changes away from FDI-led EOI economic policies. However these governments did take many incremental steps, and vastly expanded public services delivery and invested heavily in social and physical infrastructure (which in the case of Malaysia included a more extensive affirmative action program). These government policies were in fact fully compatible with maintaining and attracting new FDI. Hence the FDI-led EOI states acted within the structures of power imposed on them by the international market system.

In the developmental state there was a break from the colonial system, allowing governments to encourage indigenous industrialization. Furthermore, because of the bitter experiences of war and colonialism, there was a strong desire for economic independence by the elite. Economic growth became a source of nationalism and political legitimacy for the government. Indigenous industrialization literally became a national enterprise, justifying control of the financial, production and the knowledge structure. Because it was highly successful, these gave the governments of the developmental states further political legitimacy.

The inability of the FDI-led EOI economies to exert structural power over their economies has a lot to do with the important role of transnational capital in their economies and the perception of their governments that FDI was beneficial. For example, Singapore, due to its small size, would never be able to offer its domestic manufacturers a lucrative and protected domestic market as Japan and South Korea could. And in Malaysia, South Korean-style industrialization would probably have led to an even greater share of domestic Chinese participation in the economy and to the oppression of ordinary workers, the majority of them Malay, which would have been politically unacceptable.

Therefore the political economy of EOI is very strongly influenced by political ideas and existing economic structures. Regulation of the production structure naturally implies further regulation of the financial structure, and it appears to be very difficult to change either one. While at the same time, the knowledge structure dictates which economic policies are socially acceptable.

Understanding the ideas that shape the knowledge structure is vital for fully understanding the political economy of East Asian EOI.

Thus, the analysis supports the argument that EOI is not merely an economic policy, but a political policy and that political rather than economic circumstances shape the EOI model that is chosen. The implications of this are that important economic shifts indicate profound political changes even though the previous political order may appear to have been left intact. At the same time, this suggests that meaningful economic reform does not occur without political changes.

REFERENCES

Amsden, Alice (1989) *Asia's Next Giant: South Korea and Late Industrialization*, New York, NY: Oxford University Press.

Anchurdogy, Marie (2005) *Reprogramming Japan: the high tech crisis under communitarian capitalism*, Ithaca, NY: Cornell University Press.

Cardoso, Fernando H. and Enzo Faletto (1979) *Dependency and Development in Latin America*, Berkeley, CA: University of California Press.

Chang, Ha-Joon (1994) *The Political Economy of Industrial Policy*, London: Macmillan.

Cheng, Tun-Jen, Stephan Haggard and David Kang (1995) "Institutions, Economic Policy and Growth in Korea and Taiwan", Paper presented at UNCTAD Seminar on *Development of East and South-East Asia and a New Development Strategy - the Role of Government*, Geneva, Switzerland, Oct 30-31.

Cheung, Anthony B.L. (2000) "New Interventionism in the Making: interpreting state interventions in Hong Kong after the change of sovereignty," *Journal of Contemporary China* 9, 24, pp. 291-308.

Chia, Siow-Yue (1985) "The Role of Foreign Trade and Investment in the Development of Singapore" in *The Political Economy of East Asia: Singapore, Indonesia, Malaysia, The Philippines and Thailand, Volume I* (1995) Eds. John Ravenhill, Aldershot: Edward Elgar.

Deyo, Frederic C. (1981) "Singapore's Post-1965 Industrial Transformation" in *The Political Economy of East Asia: Singapore, Indonesia, Malaysia, The Philippines and Thailand, Volume I* (1995) Eds. John Ravenhill, Aldershot: Edward Elgar.

Easterly, William (2001) "The Middle Class Consensus and Economic Development," *Journal of Economic Growth* 6, 4, pp. 317-335.

Ferguson, Neil (2004) *Empire: How Britain Made the Modern World*, London: Penguin.

Gereffi, Gary (1998) "Comodity Chains and Regional Divisions of Labor in East Asia," in *The Four Asian Tigers: Economic Development and the Global Political Economy* Eds. Eun-mee

Kim, San Diego, CA: Academic Press.

Hall, Robert E. and Charles I. Jones (1999) “Why do some countries produce so much more output per worker than others?” *The Quarterly Journal of Economics* 114, 1, pp. 83-116.

Hill, Hal (1990) "Foreign Investment and East Asian Economic Development" in *The Political Economy of East Asia: Singapore, Indonesia, Malaysia, The Philippines and Thailand, Volume I* (1995) Eds. John Ravenhill, Aldershot: Edward Elgar.

Horikane, Yumi (2005) “The Political Economy of Heavy Industrialization: The Heavy and Chemical Industry (HCI) Push in South Korea in the 1970s,” *Modern Asian Studies* 39, 2.

Huang, Yasheng (2008) *Capitalism with Chinese Characteristics: Entrepreneurship and the State*, Cambridge: Cambridge University Press.

Johnson, Chalmers (1982) *MITI and the Japanese Miracle: The Growth of Industrial Policy 1925-1975*, Stanford, CA: Stanford University Press.

Johnson, Chalmers (1987) “Political institutions and economic performance: the government-business relationship in Japan, South Korea and Japan,” in *The Political Economy of the New Asian Industrialism* Eds. Frederic C. Deyo, Ithaca, NY: Cornell University Press.

Jomo, Kwame S. and Edmund T. Gomez (1999) *Malaysia’s Political Economy: Politics, Patronage and Profits*, Cambridge: Cambridge University Press.

Kelly, Dominic (2002) *Japan and the Reconstruction of East Asia*, Hampshire: Palgrave.

Kim, Eun-Mee (1997) *Big Business, Strong State: Collusion and Conflict in South Korean Development, 1960-1990*, Albany, NY: State University of New York Press.

Lee, Sheng-yi (1990) *The monetary and banking development of Singapore and Malaysia*, Singapore: Singapore University Press.

Lim, Linda Y.C. (1983) "Singapore's Success: The Myth of the Free Market Economy" in *The Political Economy of East Asia: Singapore, Indonesia, Malaysia, The Philippines and Thailand, Volume I* (1995) Eds. John Ravenhill, Aldershot: Edward Elgar.

Numazaki, Ichiro (1998) "The Export Oriented Industrialization of Pacific Rim Nations and Their Presence in the Global Market," in *The Four Asian Tigers: Economic Development and the Global Political Economy* Eds. Eun-mee Kim, San Diego, CA: Academic Press.

Ozawa, Terutomo (2005) *Institutions, Industrial Upgrading, and Economic Performance in Japan – The 'Flying-Geese Paradigm of Catch-up Growth*, Northampton, MA: Edward Elgar.

Pempel, T.J. (1982) *Politics and Policy in Japan: Creative Conservatism*, Philadelphia, PA: Temple University Press.

Popper, Karl R. (1963) *Conjectures and Refutations: The Growth of Scientific Knowledge*, London: Routledge.

Pritchard, Simon (2006) "A Not-Entirely-Free Economy Needs Some New Rules," *Hong Kong Journal* 1, 3.

Strange, Susan (1994) *States and Markets*, 2nd edition, London: Pinter.

Studwell, Joe (2007) *Asian Godfathers: Money and Power in Hong Kong and Southeast Asia*, London: Profile Books.

Woo, Jung-en (1991) *Race to the Swift: State and Finance in Korean Industrialization*, New York, NY: Columbia University Press.

Weber, Max (1958) *The Protestant Ethic and the Spirit of Capitalism*, New York, NY: Charles Scribner's Sons.

Yacob, Shakila and Nicolas J. White (2010) "The 'Unfinished Business' of Malaysia's Decolonisation: The Origins of the Guthrie 'Dawn Raid,'" *Modern Asian Studies*