The World Bank and the Art of Paradigm Maintenance:

The East Asian Miracle as a Response to Japan's Challenge to the Development Consensus

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"The authors conclude that rapid growth in each economy was primarily due to the application of a set of common, market-friendly economic policies....this conclusion is not strikingly new" (President Lewis Preston's preface to the East Asian Miracle, p. vi)

"[P]romotion of specific industries generally did not work" (p.24).

"More selective interventions--forced savings, tax policies to promote (sometimes very specific) investments, sharing risk, restricting capital outflow, and repressing interest rates also appear to have succeeded in some HPAEs, especially Japan, Korea, Singapore, and Taiwan, China" (p.242).

"Our evidence leads us to conclude that credit programs directed at exports yielded high social returns and, in the cases of Japan and Korea, other directed-credit programs also may have increased investment and generated important spillovers" (text, p.356)

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In September 1993 the World Bank issued *The East Asian Miracle*. The report is the result of a special Bank project to examine the experience of eight fast-growing East and Southeast Asian economies, and to learn lessons for developing countries elsewhere. That the Bank had not attempted such an overview before this time is itself remarkable. It has made overviews of other regions (notably Africa), but not of the region that for many years has been the site of the biggest success stories of the post-war era. In the event, the study was done at the urging of the Japanese government, which also paid for it. Without Japanese initiative and funding it would not have been made.

The Miracle study concludes, in the words of President Lewis Preston's preface, that "rapid growth in each economy was primarily due to the application of a set of common, market-friendly economic policies" (p. vi), that in turn created a stronger enabling environment for private sector growth. Government policies that went beyond "market-friendly" ones were generally ineffective. Policies to promote specific industries were ineffective even in Japan, Korea, and Taiwan, the so-called industrial policy champions. Directed credit (together with a subsidy element) *may* have raised investment and generated productivity spillovers in Japan and Korea but not elsewhere. On the other hand, export push policies (allowing exporters access to traded inputs at world market prices, preferential access to short- and long-term credit, and government help with marketing)[1] were generally effective.

Hence the general lessons: Market-friendly policies are everywhere the key to fast growth. Policies to promotion of specific industries, generally ineffective even in East Asia, are likely to be still less effective elsewhere. Directed credit, which may have been effective in parts of East Asia, is too risky to be recommended elsewhere. On the other hand, export push measures *are* recommended elsewhere. Broadly speaking, these are the same lessons the Bank has been promoting through the 1980s, now with a firmer endorsement of policies to export push than in the past. Overall, the study of East Asia leaves the Bank's existing paradigm unscathed. But that is not all there is to it, for the study also contains glints of arguments closer to those

[1] For details on the organization of Taiwan's export push policies see Robert Wade, 1990, Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization, Princeton: Princeton University Press, chapter 5; and "How to protect exports from protection: Taiwan's duty drawback scheme", The World Economy 14 (3), pp.299-309.

advanced by the Japanese government, making for some striking inconsistencies between different parts of the document.

We can assess *The East Asian Miracle* as a piece of economic and political analysis.[2] We can also examine it as a political document intended to find a compromise between the established World Bank position and the newly powerful Japanese position. This paper does the latter. First it describes the cause of the *Miracle* study--the build-up of tension between the World Bank and the Japanese government in the second half of the 1980s. Then it describes what happened inside the Bank once the study was underway--how the core team had to pull the original draft into closer correspondence with the Bank's established paradigm in the course of negotiations with the veto-wielding East Asia vice presidency. Finally, it describes the organizational processes and the rhetorical devices which together yielded an interpretation of East Asia that endorses the Bank's standard prescriptions, while also making concessions to the Japanese. The document contains phrases and propositions that allow both sides to claim victory, but at the price of evident inconsistencies and dubious use of evidence. From the Bank's point of view the study allows it to get on with urging other developing countries to follow the "market friendly" policies vindicated by East Asia's success, while from Japan's point of view the study, and other linked Bank studies that Japan prompted at the same time, provide a number of "attractor points" that can serve to justify research and prescriptions more in line with Japanese views.

The case study illuminates the relation between the world's biggest multilateral financial institution and the world's newly-arrived number two national economy, as the latter struggles to translate its financial strength from "rule taker" to "rule maker" and as the former struggles to reassert the dominance of already-established rules.

Pre-History

In the early 1980s the World Bank swung into line with a US-led consensus about the needs of the world economy and appropriate economic policies for developing countries. The consensus was

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2 See for example *Miracle or Design?*, op.cit. This contains critiques of the economics by Dani Rodrik and of the politics by Stephan Haggard, as well as my own assessment.

based on the twin ideas of the state as provider of a framework for private sector exchanges, and of the world economy as open to movements of goods, services, and capital (if not labor). The Bank's new Structural Adjustment Loans applied conditions in line with these ideas, such that borrowers had to shrink the state and open the economy to international transactions. Its *World Development Reports* have provided the conceptualization and evidence to justify these conditions.

The central problem of developing countries, the Bank has been saying, is the weakness of their "enabling environment" for private sector growth, where the enabling environment consists of infrastructure, a well-educated work force, macroeconomic stability, free trade, and a regulatory framework that favors private sector investment and competition. Policies to secure such an environment are collectively called "market-friendly". The "market-friendly" approach is not the same as laissez faire, the Bank is at pains to say, for it recognizes that there are market failures in infrastructure and education that the government should help to correct with public spending.[3] On the other hand, the approach warns against intervention beyond these limits, especially against sectoral industrial policies (designed to promote growth in some industries more than others). Market-friendly policies--neither complete laissez faire nor interventionism--are optimal for growth and income distribution, says the Bank.

The Bank has given particular attention to the need for financial system deregulation. Through 1988 and 1989, a Bank Task Force on Financial Sector Operations met to formulate a Bank policy on financial system reform. Its report (known as the Levy report, after its chief author, Fred Levy), published in August 1989, championed a policy of far-reaching financial deregulation for developing countries, urging removal of interest rate controls and directed credit programs.

The Japanese government, on the other hand, has been allocating its aid on a more interventionist set of principles. These principles sanction attempts by the state to prioritize activities in order to give more help to some industries than to others, the set of targeted industries changing over time. The Japanese government claims that the potential benefits of market-steering interventions in developing countries today are illustrated by the

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[3] See especially World Bank, 1991, *World Development Report 1991, The Challenge of Development*, Washington DC.

actual benefits from the sectoral industrial policies of pre- and post-war Japan, and more recently, of Taiwan and South Korea.

In line with this thinking, MITI published (in Japanese only) *The New Asian Industries Development Plan* in 1987, which set out a regional strategy of industrialization for Southeast Asian countries. Responding to the mid 1980s appreciation of the Japanese yen and the resulting need to transfer more Japanese production offshore, the plan outlined the ways that Japanese firms making location decisions consistent with the plan would benefit from various kinds of Japanese aid for infrastructure, finance, market access, and so on. Japanese officials were explicit that "Japan will increasingly use its aid...as seed money to attract Japanese manufacturers or other industrial concerns with an attractive investment environment".[4] Directed credit was to (continue to) be a key instrument.[5]

In the late 1980s Japan's Ministry of Finance established the ASEAN-Japan Development Fund, which offered subsidized targeted loans to support private sector development. The fund was administered by OECF, Japan's biggest aid agency.

By the second half of the 1980s the contrast between World Bank prescriptions and Japanese aid practices began to generate tension between the World Bank and the Japanese government (and indirectly between Japan and the US government). The Bank made some acerbic criticisms of Japanese aid in Southeast Asia, arguing that Japanese aid for interventionist policies undermined what it was trying to achieve.

In particular, in September 1989 a senior vice-president of the World Bank wrote to the president of OECF asking him to reconsider the policy of subsidized targeted loans. The senior

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[4] Tadao Chino, then vice-minister, Minister of Finance, in 1991, quoted in Edward Lincoln, 1993, *Japan's New Global Role*, Washington DC: Brookings Institution, at p. 124.

[5] For a brief description of the plan in English, see for example Japan Economic Institute, report No. 22A, June 18, 1993, p.9. The empirical and analytic underpinnings of the plan were put in place by detailed and coordinated studies of natural resources, trade and industrialization in Southeast Asian economies, over the 1970s and 1980s, by MITI economists and Japanese academics (including Professor Torri, of Kieo University). The plan and its history illustrate the long-term nature of Japanese planning, and the coordination between government and firms. One sees the results of the plan in the simultaneous spurt of Japanese FDI and Japanese aid to Thailand in 1988. Much of the aid was for the construction of industrial estates reserved for Japanese companies. The companies were exiting from Japan to escape the high and rising yen and the resulting high labor costs.

vice-president said that passing these funds to the banks and final beneficiaries at below market interest rates "could have an adverse impact on development of the financial sector" and hence *"would create unnecessary distortions and set back the financial sector reforms"* which had been supported by the IMF's Extended Fund Facility and the Bank's Financial Sector Adjustment Loan .[6] Hence the Bank could not continue to lend for financial system reform in the Philippines if OECF did not remove its interest rate subsidies and earmarking.

The dispute highlighted the underlying differences of view. The Japanese argued that financial policies should be designed to advance a wider industrial strategy; the Bank insisted that credit should, in real world conditions, be at "market" or non-subsidized rates and should not be earmarked.[7]

Japan's executive director made strong protests to senior management and to the Board (made up of executive directors from member governments). Many executive directors from developing countries agreed with the Japanese position. Bank management would not modify its stance.

Japan's Ministry of Finance and its OECF began to fight back. A key figure was ISO Kubota, a senior MOF official then on loan to OECF as managing director in charge of the pivotal Coordination Department. First, he established a team to write a paper setting out the broad principles of the Japanese government's understanding of structural adjustment. Second, he and Japan's executive director at the World Bank, Masaki Shiratori, discussed how to get the Bank to pay more attention to the Japanese and

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6 Emphasis added. According to a Bank official closely involved, the story began in 1986 when the Bank agreed to help the government of the Philippines restructure two major public sector banks (including the Development Bank of the Philippines). The banks were both bankrupt, partly because they had become patronage pots--with directed credit as the primary means of patronage. Their restructuring involved eliminating directed credit. Then along came the Japan-ASEAN Fund offering directed credit with a substantial subsidy element for narrowly earmarked purposes--the same instrument the banks had been using to dispense patronage. This was very difficult for the Bank to swallow. "I remember many heated meetings in Tokyo and here in Washington", he said.

7 On the contrast between the Japanese and American approaches to these issues, as seen through Japanese eyes, see Hidenobu Okuda, 1993, "Japanese two step loans: the Japanese approach to development finance", *Hitotsubashi Journal of Economics* 34: 67-85. See also ISO Kubota, 1993, "The East Asian Miracle--major arguments on recent economic development policy", *Finance* (monthly journal of Ministry of Finance), December (Japanese).

wider East Asian development experience. *This is the genesis of the Miracle study.*

The OECF (whose main parent ministry is the Ministry of Finance) issued the above mentioned paper in October 1991.[8] Its main points:

1. For a developing country to attain sustainable growth the government must adopt "measures aiming 'directly' at promoting investment".

2. These measures should be part of an explicit industrial strategy designed to promote leading industries of the future.

3. Directed and subsidized credit has a key role in promoting these industries, because of extensive failures in developing country financial markets.

4. Decisions about ownership arrangements, including privatization, need to be made in relation to actual economic, political, and social conditions in the country concerned, not with respect to an overriding rule about the universal desirability of privatizing public enterprises. For example, there are legitimate national concerns about the extent of foreign ownership.

5. "Japanese fiscal and monetary policies in the post-war era may be worthy of consideration. These were centered on preferential tax treatment and development finance institutions lendings" (p.5-6).

At the October 1991 Annual Meeting of the Board of Governors of the World Bank and the IMF Yasushi Mieno, head of the Bank of Japan (the central bank)[9], repeated the Japanese view. "Experience in Asia has shown that although development strategies require a healthy respect for market mechanisms, the role of the government cannot be forgotten. I would like to see the World Bank and the IMF take the lead in a wide-ranging study that would define the theoretical underpinnings of this approach and clarify the areas in which it can be successfully applied to other

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[8] "Issues related to the World Bank's approach to structural adjustment: proposal from a major partner", Occasional Paper No. 1, October 1991.

[9] He was deputizing for the Finance Minister, who is the Governor of the Board for Japan.

parts of the globe."[10] Mieno's statement was prepared by the International Finance Bureau of the MOF. ISO Kubota (by now transferred back from OECF to a senior position in this bureau) later made the point more vividly to reporters: "It's really incredible. They think their economic framework is perfect. I think they're wrong."[11]

Soon afterwards articles began appearing in the American and Japanese press with headlines like "Japan-US clash looms on World Bank strategy", based on interviews with Japanese officials. The anonymous Japanese officials called the Bank's approach "simple minded", and based on "outmoded Western concepts that fail to take account of the successful strategy pursued by Japan and some of its Asian neighbors in developing their economies".[12] Privately they accused Bank economists of gross arrogance, of presuming to lecture them on why the Japanese government is doing the wrong things and then asking for more Japanese money.

The Bank's View of the Japanese Position

Bank officials see the Japanese position as a serious threat. Why?

First, Japan has become much too powerful to be ignored. It controls the biggest bilateral aid budget in the world (since 1989); the second biggest block of shares in the World Bank (since 1984); and also the second biggest block of shares (equal with Germany) in the IMF (since 1992).

Second, concessional credit from the Japanese aid budget makes World Bank credit less attractive. The Bank especially needs to find borrowers in East and Southeast Asia, where Japanese aid is concentrated, in order to raise the average quality of its loan portfolio.

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[10] World Bank, press release no. 16, October 15, 1991, cited in Chalmers Johnson, 1993, "Comparative capitalism: the Japanese difference", *California Management Review*, Summer, 51-67.

[11] Quoted in "Japan wants strings on aid: at odds with US, Tokyo urges managed economics", *International Herald Tribune*, 2 March 1992.

[12] The title and quote come from an article by Rich Miller, in *The Journal of Commerce*, December 11, 1991, p.1a. See also "Free market theory not practical in Third World: interview with Masaki Shiratori", EIR, March 27, 1992. And "Japan challenges World Bank orthodoxy", *Far Eastern Economic Review*, March 12, 1992, p.49; "Japan presses World Bank on lending: nation begins asserting independent voice in global forum", *The Nikkei Weekly*, March 12, 1992, p.3.

Third, the Bank's legitimacy is based partly on its role as intellectual leader of the transnational consensus about how to manage the world economy, and by challenging the consensus the Japanese also challenge the Bank's legitimacy as leader. The Bank's commitment to the consensus is important for its ability to borrow, and therefore for its survival. The consensus reflects the ideology of those who own and manage global financial capital--that only one set of rules should apply to all participants in the international economy and that those rules should express a non-nationalistic role of the state. The Bank's ability to borrow at the best rates on world money markets--and lend at the best rates, and so survive in the face of competition from other financial agencies--depends on its reputation in the eyes of financial capitalists; which depends on its manifest commitment to *their* version of "sound" public policies.[13] Its reputation as a country-rating agency, a kind of "international Standard and Poor"[14] that signals to private investors where they should put their money, is the Bank's second most valuable asset (after its government guarantees). To sustain the reputation it must be seen to be very authoritative. Like God and for the same reason, it cannot afford to admit it is wrong.

Fourth, the Bank's constitution requires it to be "apolitical", and the single meta-policy, sanctioned as it claims to be by a transcendent and apolitical "economic rationality", helps the Bank preserve the claim of "political impartiality". One of the

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[13] This, at least, is how Bank officials often state the matter. The truth is more complicated. The Bank's top grade credit rating depends in the first place on its non-borrowing governments' guarantees and its first claimant status for borrowing governments (this status being enforced by knowledge that a non-repaying government will get no more aid from a World Bank-affiliated government). Therefore the Bank's top grade credit rating does not depend on financial markets' evaluation of the quality of its loan portfolio. Rather, the link between its credit rating and its reputation for "sound" lending conditions comes via the legislatures of the non-borrowing governments. The decision to honor the guarantees would not, in practice, be automatic. The US Congress, in particular, would have to authorize the expenditure, and has a long history of delaying authorization of foreign appropriations. If it held the Bank in disrepute it may delay authorization of the guarantee expenditures for a long time. Whether it holds the Bank in disrepute depends on the Bank's reputation in the eyes of financial markets. Much of what the Bank says in its flagship publications is vetted with this in mind; see especially the two recent *World Development Reports* that have provided a broad overview of development experience and theory, those for 1987 and 1991.

[14] Standard and Poor is one of the two main US investment rating agencies.

most important conceptual contributions of the Bretton Woods conference (which created the World Bank and IMF) was the idea of equal and uniform treatment of all members of a new financial order. It was intended to avoid the politicization of the 1920s international rescue operations. There would be no "favorites", but a community of states supporting each other at times of difficulty by means of a universalistic set of rules.

To now admit the potential efficacy of sector-specific industrial policies would require the Bank to discriminate between countries in terms of such things as government capacity and corruption, on the quite reasonable grounds that industrial policies are unlikely to be effective in states whose governments are thoroughly corrupt. But doing so would expose it to the damaging charge of being "political", and open it to pressure from *borrowers* saying, "You urged/allowed country X to do A, why can't we?".[15]

Fifth, the validity of the meta-policy matters for the Bank's ability to act quickly and concertedly. The meta-policy is derived from neo-classical economics and receives the endorsement of most US- and UK-trained economists.[16] Economists, most of them certified by US or UK universities, took control of the Bank over the 1980s.[17] Their common acceptance of the meta-policy--an implicit condition of appointment--allows them to identify quickly the right direction of action for any developing country. Policies seen to be inconsistent with neo-classical normative theory (including some wanted by the Japanese) can be ruled out from the start, making advice-giving more efficient.

Of course, the Bank's lending practices on the ground in particular countries have often differed from what the recipe calls

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[15] In fact, since the early 1990s, the Bank *has* begun to talk more overtly about politics, but warily and in the reassuringly technical language of governance ("accountability", "transparency", "predictability", and so on). Even this has generated unease and opposition within the Bank and within the Board, on grounds that it risks being inconsistent with the charter. The issue came to a head in a Board discussion about a three-years-in-the-making research department study entitled "Bureaucrats and Business", in July 1995, when some EDs argued strongly that the Bank should not be talking about these issues (the French ED in particular, perhaps with governance in ex-French sub-saharan African countries in mind).

[16] Bruno Frey et al, 1984, "Consensus and dissensus among economists: an empirical inquiry", *American Economic Review* 74 (1).

[17] Nick Stern, 1993, "The Bank as an intellectual actor", paper for World Bank History project, London School of Economics.

for. But these case-by-case modifications come from the need to adjust pragmatically to "political realities" on the ground and in the Bank, not from a belief that the *economics* of the meta-policy might be less universal than is claimed. (So China, with one of the most interventionist, price-distorting governments of all, was the Bank's fastest growing borrower over the 1980s. The Bank and China need each other, China to get finance and intellectual help, the Bank to lend to a big absorber with little debt.) At the level of principles the neo-classical/largely free market meta-policy is insulated from the case-by-case modifications.

Finally, the Bank sees the Japanese position as posing a threat not only to itself but also to the world economic order as a whole. The Japanese position requires the developing country state to play the role of *mediator* between national interests and the global order, not just a transmission belt from the "realities" of the world economy to the national economy. Such a role, says the Bank, generally brings lower levels of national welfare; but even if it raises national welfare in one case it can do so only by "free riding" on the restraint of others--promoting industries to compete in US markets while closing the domestic market to US exports, for example. So the Japanese principles cannot be practiced by all at the same time, and in that sense pose a systemic threat.

Against this background, one understands the danger for the Bank in the Japanese claim that the most successful countries of all followed policies rather different from the formula; and the still greater danger in the Japanese claim that in some conditions some degree of government dirigism could be effective even in today's developing countries. If these claims were endorsed a more custom-tailored approach to policy prescription would be required; and the Bank would have to take explicit account of the implications of one country's custom-tailored package for the design of others'--a task it has largely avoided. Similarly, one understands the danger in the Japanese claim that directed credit could be effective. The claim runs against a central argument of the Bank over the 1980s, that in real world developing country conditions directed credit can rarely if ever be effective. If the Bank admitted truth in what the Japanese say, it would implicitly admit it had earlier been wrong.

History

To recap: In 1989 the Bank makes a strong criticism of the Japanese aid agency, OECF, for its credit policies in Southeast Asia. In response senior MOF officials consider how to get the Bank to be more "pragmatic" and to pay more attention to the experience of Japan and other East Asian economies.

In 1991, soon after the arrival of Lewis Preston as the new president of the World Bank, the Japanese Ministry of Finance presses the Bank to make a thorough study of East Asian development experience. The senior management is reluctant to permit the study. It agrees because the Japanese will pay for it,[18] the Bank having to bear only the time of its own staff[19], and because the Japanese in return will drop their opposition to the draft Operational Directive on Financial Sector Operations, which had been the subject of acrimonious debate in the Board.[20]

In January 1992 the study gets under way, with a budget of $1.2 million dollars from the Japanese trust fund.[21] It is to be done over 18 months for publication at the time of the Annual Meeting in 1993. The work is divided into the core study and the country case studies. The core study, giving the overall analysis and conclusions, is to be based in the Bank's research complex under Lawrence Summers (vice president for research, American) and Nancy Birdsall (director of research department, American). They

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[18] The money will come from Japan's amply endowed Policy and Human Resource Development trust fund for the World Bank. Many rich country members of the Bank have trust funds. The funds are controlled jointly by the member country and the Bank, to cover jointly agreed operational expenses of the Bank. Twenty percent of the Bank's operational budget is now met from trust funds. The great advantage of this arrangement from the rich country governments' point of view is that each government has a direct say in how "its" money is used. If at the same time the same governments squeeze the regular budget, they are able to gain pleasing *bilateral* influence over the Bank.

[19] In the late 1980s, the Bank had similarly got the governments which had been voicing concern about the impact of structural adjustment programs on vulnerable groups--the "soft" northern governments--to finance much of the Bank's work on the design of anti-poverty programs.

[20] It emerged as Operational Directive 8.30, Financial Sector Operations, February 1992, the work, largely, of those who had earlier written the Levy Report. The Japanese were its main opponents in the Board. An Operational Directive is the most mandatory of Bank policy statements.

[21] Bank staff costs amount to about $800,000 ($150,000/year x 1.5 years x 3.5 persons). The Bank provides another $200,000 for miscellaneous costs. This brings the total Miracle study budget to a bit over $2 million, about the same as for a World Development Report.

appoint John Page (DPhil in economics from Oxford, undergraduate economics from Stanford, American) to head the study. Page puts together a core team of six people plus himself, all with PhDs in economics, all but two from American universities.[22] Not one has adult experience of living and working in Asia.

The country case studies are to be done from the Bank's East Asia vice presidency, some by authors inside the Bank, others by outsiders. The outsiders are offered $10,000 per country case study, and required to submit drafts in six months. (So their research has to be largely off-the-shelf.) In addition, several background papers are commissioned about Japan from Japanese scholars.

The East Asia vice presidency, although it gets the country studies, feels by-passed. The vice president for East Asia first hears of the study at a Board meeting. Asked by an executive director for his views about the proposed study, he confesses not to know about it. He is not amused. Summers by-passes the East Asia vice presidency because he knows that its senior managers and economists hold views towards the free market extreme of the Bank's range.

At the same time, a parallel and complementary project is initiated, again with Japanese funding, to examine the effect of directed credit in Japan. This is undertaken on behalf of the Bank by the Japan Development Bank, reviewing its own programs. Its

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[22] Other Bank staff include Ed Campos (Filippino, US PhD in the social sciences [de facto, economics] from Caltech, works on institutional issues), Marylou Uy (Filippina, US PhD in economics from UCLA, works on financial issues). Page, Campos, Uy work full-time on the study; Birdsall works half-time. The main consultants include Max Corden (Australian, trade economist, works on macroeconomics); Joseph Stiglitz (American, economic theorist, works on finance); Howard Pack (American, development economist, University of Pennsylvania, works on tests of the effectiveness of selective industrial policy); Richard Sabot (American, development economist, Williams College, works on human capital). Nancy Birdsall also works with Sabot on human capital. A commentator on an earlier draft, who helped to manage the study, queried my presentation of the personnel: "Why do you emphasize the fact of so many Americans? It seems you are implying that because we are Americans we had predetermined conclusions. In fact, we were eager to find a story that would be new. Anyway, you are misleading because the team's composition was about average for World Bank economists." It is true that the Bank employs very few East Asian economists (but a lot of US-or UK-certified South Asian economists). Experience of employing Japanese economists has been disappointing, the Bank being unwilling to hire them in groups.

conclusions are to feed into the Miracle study.[23] A third Japanese-funded study about Japan gets going on "The evolution, character and structure of the Japanese civil service, and its role in shaping the interrelationships between the government and the private sector". It is undertaken by the Bank's Economic Development Institute (EDI), the educational arm of the Bank, for use in World Bank teaching courses. Suddenly the Bank is paying a lot more research attention to Japan than ever before, thanks to Japanese initiative and Japanese money.[24]

From early 1992 to early 1993 the first drafts of the East Asian Miracle chapters are written and discussed within the core group. John Page is given a free hand by senior managers, with no hint of the expected conclusions. Lawrence Summers urges him to think in new ways, to listen carefully to the Japanese arguments. "We were eager to find a story that would be new, all the more so because the Bank's standard 'market-friendly' story had already been told in *World Development Report 1991*", said Page later. Indeed, Summers' reaction to Page's proposed names for the team is: "Too neo-classical, you will be seen as trying to force East Asian data into a neo-classical straight-jacket". Page responds that for the report to have an impact in the Bank and in North America it has to use the language of neo-classical economics. The team stays as Pages proposes.

They accept that East Asian governments implemented policies at substantial variance from the Bank's orthodoxy. But they find it difficult to find clear evidence about the causal impact of these non-orthodox policies on economic growth. They wrestle with this issue for many months. Eventually they say: it is possible that some of these non-orthodox policies helped some of the time, but, with some exceptions, we can't show it.

Also at this time, the first version of the "institutional basis" chapter is restructured. The first version had taken as its main question, "what features of East Asian institutions enabled these economies to avoid the costs that befall equally interventionist and authoritarian states elsewhere; or why did their many strategic interventions not lead to massive rent-seeking?" It presented government-business consultative councils, for

23 The JDB's data is also made available to two American economists for independent econometric assessment of the effectiveness of the credit policies.

24 There is also a comparative study of tax systems in Japan, Taiwan, Korea, and India. The additional studies have a combined budget of $ 1.8 million from the Japanese Trust Fund.

example, as an institutional device that reduced the authoritarian character of East Asian political regimes, by providing an institutionalized channel of feedback from the people directly affected by business policies. Birdsall and Page consider that this might be interpreted as sanctioning authoritarianism and interventionism--as saying, "If you have institutional features X, Y, and Z you can avoid the expected costs". In the rewriting, this theme is much diluted. The chapter is brought into line with the report's larger argument that East Asian states were more successful because *less* interventionist, and the implication that some authoritarianisms are better than others is removed.

Around March of 1993 the last stage of the production process begins: rounds of discussion at successively higher levels of the approval hierarchy. A full-time editor is hired from the Asia Wall St. Journal.[25] Over the next several months he and Page iterate back and forth, the editor revising the drafts in line with comments, Page commenting on the editor's revisions, the editor taking on board Page's comments and resubmitting to Page. The editor is the only person involved in the project with adult experience of living and working in Asia. He attempts to inject some discussion of cultural propensities to save and educate, and of the role of the overseas Chinese network. The team rejects his suggestions, the former as being too difficult to pin down with evidence, the second as being too liable to be interpreted as racism.

Many meetings are held with people from the East Asia vice presidency to discuss individual chapters and the draft as a whole. The East Asia people attack the work for excessive emphasis on government intervention. "Where is the *evidence* for what you are saying?", they keep demanding. The East Asia vice presidency is well versed in demolishing arguments about the efficacy of industrial policy, its chief economist having just co-authored a book reiterating a largely free market interpretation of East Asian economic success[26]; and its vice president provides support for such challenges, still smarting from being excluded at the study's initiation. Its representatives badger the team about "strategy", as in the working subtitle, "Strategies for Rapid Growth", and as in phrases like "a strategic approach to growth".

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[25] The editor is Lawrence MacDonald, also American. He works intensively on the drafts and redrafts from March to September 1993.

s[26] Ramgopal Agarwala and Vinod Thomas, 1993, *Sustaining Rapid Growth in East Asia and the Pacific*, World Bank: World Bank Publications.

They suspect that these words are being used in implicit contrast to their own favored "market friendly" phraseology. They claim that use of these words could be misconstrued to mean that East Asian growth was due primarily to "strategic" (industrial policy) interventions, or even to mean that there is an alternative East Asian type of capitalism. The East Asia representatives also argue, more generally, that the Bank has an interest in getting the market friendly approach, as set out in the *World Development Report 1991*, accepted as the correct approach to economic policy in all developing countries, and it would look odd if the study of East Asia, of all regions, did not embrace it too. Not coincidentally, the *World Development Report 1991* was written by a team headed by the man who is now chief economist for East Asia.

The spectacle of the East Asia vice presidency evacuating upon the draft convinces Page and Birdsall to make concessions so that the draft will proceed up the approval hierarchy. How to get the East Asia vice presidency off their backs? First, they recognize that "strategy" and "strategic" imply--to the East Asia vice presidency--a stronger argument about the efficacy of industrial policy than they wish to make, and are distracting attention from the substance of the argument about market failures. All references to strategy and strategic are therefore removed, being replaced, where necessary, with the innocuous "functional", as in "a functional approach to growth" (p.88, figure 2.1). Second, they praise the "market friendly" approach in several places. Preston's preface is made more explicit: "The authors conclude that rapid growth in each economy was primarily due to the application of a set of common, market-friendly economic policies" (p. vi). At this late stage the editor is asked to write a box summarizing the ideas and evidence for the "market-friendly" approach (box 2.1, p.85). He writes, "In the past twenty years a consensus has emerged among economists on the best approach to economic development.... These ideas have crystallized into what is now called the 'market-friendly' approach".

By making these concessions they hope to protect two key ideas in what they had earlier called "strategy". One is that growth is a function of three sets of policies--policies to foster accumulation, those to foster efficient allocation, and those to foster productivity growth. Whereas the standard neo-classical argument (as in the "market-friendly" approach) says that you need good performance on all of four dimensions (macroeconomic stability, trade openness, human capital, and a rule-based system hospitable to the private sector), they think that there is some substitutability between the policies for accumulation, allocation, and productivity. Hence it is conceptually possible that costs in allocative efficiency (due to distorting industrial policies) are more than offset by gains in productivity (due to learning). The second idea is that markets--effective coordinating mechanisms for private agents in many contexts--may not work well for lumpy investments in the early stages of development; for these, other mechanisms are needed, such as "deliberative councils". But how to stop deliberative councils from becoming cozy havens for sharing out rents? Answer: contests, in which selected firms compete within tight rules and under the watchful eye of government as referee.[27]

Other parts of the report also come in for strong criticism from the rest of the Bank (all the more so now that Summers has gone[28]), but end up in the final version little changed. The section on directed credit and financial repression is attacked for making too many concessions to the view that these instruments could sometimes work. Page counters that the section does not repudiate the Bank line, as the critics contend. It says clearly, he says, that there is no *proof* that directed or targeted credit worked in Japan and Korea; but it also says clearly that the normal adverse effects of directed credit are *not* seen in those countries. Similarly on the wider question of financial repression. Page counters trenchant internal criticism by urging the critics to read carefully what the text actually says. While admitting the impossible-to-deny fact of financial repression in Japan and Korea, the text's explanation for why the normal adverse effects on growth are not observed is not out-of-line with established Bank thinking, says Page: the normal adverse effects are not observed because the degree of repression has been *moderate* (thanks to macroeconomic balance and only slightly concessional interest rates for priority uses). This is the section of the report of greatest interest to the Japanese sponsors. Its credibility is bolstered by the pre-eminent status in the American economics profession of its main author, Joseph Stiglitz, winner of the John Bates Clark medal for outstanding work by an under-40 economist. In the event, despite all the criticism, the section is left largely unchanged.

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[27] "Government as referee" has a powerful resonance in neo-classical economics, and the link to contests takes it towards East Asian realities; but it obscures the point that the government sometimes acts as referee and player at the same time.

[28] To be Under Secretary to the Treasury for International Affairs in the new Clinton administration.

The "institutional basis" chapter, though already revised and diluted, is attacked as the document goes up the approval hierarchy. Many critics call for references to authoritarianism to be dropped. Birdsall and Page defend the chapter, successfully, including oblique references to authoritarianism.[29]

As the deadline looms,[30] intense effort is made to present a consistent message. The Bank's senior in-house editor is brought in. He pastes each chapter page by page along the wall of a conference room. Together with several members of the team, he takes a birdseye view, suggesting how to bring the messages up front. He pays special attention to the headings on the assumption that many readers will not go beyond them. Headings should themselves give the argument, he urges. Parts of the draft are revised to emphasize the neo-classical "fundamentals". Results of the econometric tests of the effectiveness of selective industrial policy are rephrased to make them more conclusively contra than in the original draft.

Page later explains his principle for responding to criticism: if he agrees that the evidence is not strong enough to support a certain proposition, he tones the statement down regardless of whether it is Bank orthodoxy or not. At the same time, he has to recognize that this is a World Bank document with an "anonymous" author, that sets out a Bank-wide position. Therefore it should not go outside the range of views that are represented within the Bank, it should steer between the extremes. A senior manager later remarks: "Without the strong leadership of Larry Summers, Nancy Birdsall, and John Page, the report would not have moved anything like as far [from Bank orthodoxy] as it did."

In August 1993 the World Bank executive directors (EDs, country representatives) consider the final draft. Their reactions show nothing like consensus. The US ED gives a glowing endorsement of what he takes to be the free market message of the report. (Some of the core team are disturbed to hear how he "spin-doctors" away all their qualifications.) The newly arrived

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[29] See for example p.188.

[30] The draft is also discussed in a Singapore roundtable (including senior or ex-senior government officials from Singapore, Malaysia and Indonesia) and in Tokyo (three meetings with individual senior officials who give detailed comments on the first draft: Kubota (MOF), Tsukuda (number two in OECF), and Ogata (Deputy Governor, Bank of Japan). Individual chapters are presented by members of the Bank team to academic seminars in Singapore, Indonesia, and Korea.

Japanese ED is cautiously complimentary. The Argentinean ED says, angrily, that the whole report is an apologia for interventionism. The Indian ED comes close to saying that the report's anti-interventionist conclusions were fixed in advance and the evidence juggled to fit. Few changes are made in response to the Board's comments.[31] If one is being attacked from all sides the argument must be about right, Page later explains.

On September 26, 1993, exactly on time, *The East Asia Miracle: Economic Growth and Public Policy* is launched at the Annual Meetings of World Bank and IMF. There is a press conference, a press release, and a seminar for Annual Meeting participants. The report "sells itself", because of outside interest. After attending the same news conference, some journalists (mainly Japanese) highlight the effectiveness and replicability of East Asia's government interventions, others (mainly American and British) highlight their ineffectiveness and unreplicability. The London-based *Financial Times* leads its review of the report with, "Industrial policies to promote particular sectors or companies have been a failure in east Asia and do not explain the region's rapid growth in recent decades, according to a World Bank study". The *Nihon Keizai Shimbun*, Japan's leading business paper, says, "the report cites the accumulation of high-grade human and physical capital as a motivating force and highly evaluates the effects of government intervention...." [32]

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[31] Unknown to the EDs the document has already been typeset by the time of the Board discussion, so as to ensure it would be available in time for the Annual Meeting. But the version sent to the Board has been revised in the month between being sent to the Board and being discussed by the Board. Many of the revisions address issues that the Board brings up, and are subsequently reported to the Board as being made *in response to* Board suggestions.

[32] *Financial Times*, 27 September 1993, p.16. *Nihon Keizai Shimbun*, 26 September 1993, p.7. The *Far Eastern Economic Review* (owned by the American firm Dow Jones) concludes from the study that, "today the price of growth is eternal vigilance against sometimes well-intentioned efforts to 'help' selected industries or otherwise substitute bureaucratic preferences for the millions of individual decisions that each day constitute the wisdom of the marketplace" (21 October 1993, p.5). The *Daily Yomiuri* begins its report, "Economic policies that fuelled East Asia's dynamic economic growth over the past 30 years can also work in other developing regions of the world, according to a new World Bank study...." (27 September 1993, p.7)

End of History?

MOF officials celebrate the fact that the Bank has at last admitted that state intervention can be useful. But they are also highly critical of some of the conclusions. Former executive director Masaki Shiratori, now in OECF, makes a hard-hitting critique at a seminar in Tokyo, December 1993. He argues, "Comparative advantage should be regarded as a dynamic notion rather a static one....It is theoretically right to pick and nurture specific promising industries which do not have comparative advantage now. Many developing countries desperately need to get rid of the monoculture in such commodities as coffee, cocoa, copper and tin, which resulted from static comparative advantage....A latecomer to industrialization can not afford to leave everything to the market mechanism. The trial and error inherent in market-driven industrialization is too risky and expensive considering the scarcity of resources." He goes on to make a number of theoretical and technical points against the Total Factor Productivity test of the effectiveness of selective industrial policy. And concludes, "In view of these theoretical and technical problems in the Report's analysis of industrial policy, I hope further studies will be made within and outside the World Bank. In the meantime, I sincerely wish that the Bank will adopt 'pragmatic flexibility' in prescribing policy advises to developing countries".[33]

ISO Kubota concludes his remarks at the same seminar: "Perhaps the best lesson could be that policy makers and policy advisers, including those in the World Bank, should not be dogmatic but be pragmatic. For that purpose *modesty, not arrogance, and sincere attitude* toward finding right policy measures, are essential".[34]

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[33] Masaki Shiratori, 1993, "The role of government in economic development: comments on 'East Asian Miracle' study", paper presented to OECF seminar on the World Bank's East Asian Miracle study, December 3, Tokyo.

[34] ISO Kubota, 1993, "On 'Asian Miracle'", mimeo, Ministry of Finance, his emphasis. An American source close to the Bank, who has talked at length to senior MOF officials about the report, characterizes their reaction as follows: "We feel intellectually vindicated, because the report does recognize that selective credit has worked effectively in Japan and Korea. We are now beginning to find our intellectual voice on development issues, even if our voice does not yet match the size of our financial contribution. We regard the Miracle study as a start. We will now wait, regroup, and exert quiet pressure on the Bank to be more pragmatic in its policy advice."

A senior MOF official close to the *Miracle* study characterizes MOF and MITI reactions as follows: "MOF people consider this a good step forward, although they are not fully satisfied with the study's negative assessment on industrial policy. The reaction of the MITI people is mixed: they share the MOF view on the one hand, but they are afraid to be accused of excessive intervention *now* in the course of negotiations with the US and the EC". He refers to MITI concerns as expressed by, for example, Makoto Kuroda, MITI's best known hard-line negotiator with the US: "We must not provide a dangerous basis for the argument that says Japan conducts itself by a different set of rules and must be treated differently.... For some time I have repeatedly stated that we should avoid expressions such as 'Japanese-style practices'".[35]

Opinion about the *Miracle* study within the Ministry of Trade and Industry seems to differ between the two key bureaus, the International Trade Bureau and the Industrial Policy Bureau. The former is preoccupied with maintaining access to the *American* market, for which avowed commitment to "free market"/"level playing field" symbols is important; people from this bureau tend to be enthusiastic about the study's conclusion that selective industrial policy has by and large been ineffective in East Asia. The Industrial Policy Bureau on the other hand is committed to boosting the idea of MITI's successful steerage of the Japanese economy, and people from this bureau tend to be more critical of the study. MOF's critical stance toward the study may reflect MOF concerns to maintain a strategic aid program using directed credit and other infant industry incentives. The two agendas--that of the International Trade Bureau of MITI and that of MOF--may reflect a single higher-level strategy, to maintain access to the American market over the five year middle-run, while building up a dense presence in the Southeast Asian and China markets for the 10 year longer run, when these markets are expected to be more important than the American.[36]

Within the Board of the Bank, Shiratori's successor as Japan's executive director is less active all around. He does not push the concerns that lay behind Japan's promotion of the *Miracle* study. This may reflect a high-level decision in Tokyo to calm relations with the World Bank in order to avoid causing even more turbu-

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[35] Quoted in Chalmers Johnson, 1993, op. cit., p.59.

[36] Indeed, a watershed has already been reached in Japan's trade: for the first time the surplus with Asia exceeded the surplus with the US in fiscal year 1993/4.

lence in Japan's relations with the US. As part of this calming strategy, the Japanese government agreed with the Bank that its directed credit programs, though they continue, will not use narrow earmarking (will not define beneficiaries narrowly) and will not have a big subsidy element (not more than one or two percentage points below market rate).

If the Japanese government has left off pressuring the Bank it has not stopped promulgating its ideas in developing countries. On the contrary. Seeing "the Japanese approach to industrial policy" as a new export product, it is building up an enormous capacity for teaching Asian bureaucrats, industrialists and scholars about the Japanese approach to industrial policy. One of the leading figures in this campaign recently declared, "Free market theory has failed in many areas like Russia, eastern Europe, and sub-Saharan Africa because it is too short sighted and too market oriented. Not enough attention was paid to these countries' own economic and social structures....Japan started from a planned economy post war, to become gradually liberalized over the years. I would say we are now 80 percent of the way to being a free market economy. In developing countries it should be more like 50 percent. We are not saying that developing countries should imitate Japan. But they do need to study an alternative to neo-classical economic theory". To supply them with such an alternative, in 1995 between 500 and 600 foreign government officials will attend courses in economic development run by the ministries of international trade and industry, finance, foreign affairs, and the Bank of Japan. Scores of Japanese officials will also leave Tokyo on secondment to developing country governments, or to swell the small ranks of Japanese officials in multilateral development agencies. Most of the countries targeted for receiving this attention are also lucrative markets for Japanese goods.[37]

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[37] The quoted official is Mr Katsuhisa Yamada, director of Japan's Institute of Developing Economies. See William Dawkins, "Pedlars of the Japanese model to developing world", *Financial Times*, 7 February, 1995. The Japanese are also helping to keep the debate going in the OECD academic world. During 1994 OECF invited scholars in OECD countries to write short comments on the Miracle study. For the eight comments from UK-based respondents plus two Japanese commentaries on the *Miracle* see *Journal of Development Assistance* (Research Institute of Development Assistance, OECF), v. 1, n. 1, July 1995 (in English). OECF's OECD country offices have also arranged meetings with academics in their respective countries to discuss papers such as the Economic Planning Agency's "Possibility of the application of Japanese

What about the Bank itself? A senior manager says, "We simply cannot afford to take a more custom-tailored approach to lending conditions, as the Japanese have been urging. If we were to say to Philippines, 'It is OK for Malaysia to do this but not for you', we could be accused of violating the political impartiality condition of our charter".[38]

No follow-up research is planned. The director of the research department explains that "...the real issue is the relevance of the East Asian experience for other developing countries.... Now the East Asian study is completed, the research agenda lies more in Africa and other developing countries than it does in East Asia". He takes for granted that "the East Asian experience" whose relevance is being considered is the experience as interpreted in the *East Asian Miracle.*[39]

The World Bank and the Art of Paradigm Maintenance

The World Bank is a large institution, with some 4,000 professional[40] staff drawn from many countries, producing dozens of public reports a year. How does it manage to deliver what the outside world hears as a single central message?

The art of paradigm maintenance begins with the choice of staff. Eighty percent of Bank economists are North American or

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experience from the standpoint of the developing countries", November, 1994.

38 This is from an American source close to senior levels of the Bank (himself a former senior official), who asked the senior-most manager for his view of the report.

39 See Lyn Squire, 1993, Remarks in "Proceedings of the Symposium on the East Asian Miracle", symposium hosted jointly by the World Bank and the OECF, December, OECF, Tokyo. The Bank may have continued to do a little more, on the research side, if any one of the three main protagonists, Summers, Birdsall, and Page, had remained in or close to their positions; but they all moved far from where they could influence the follow-up. Nancy Birdsall went to be Executive Vice President of the Interamerican Development Bank, John Page became Chief Economist for Bank's Middle East region, and Lawrence Summers, as mentioned, became Under Secretary to the Treasury for International Affairs in the Clinton administration.

40 In Bank parlance, Higher Level Staff; total staff (including temporaries) in FY1994 is just over 8,000.

British trained,[41] and all but a few share the preconceptions of mainstream American and British economics. If they were to show sympathy for other ideas--if they were to argue that sectoral industrial policies can in some circumstances be effective, for example--they would be unlikely to be selected for the Bank, on grounds of incompetence. The organization's few non-economist social scientists are employed for marginal issues like resettlement and participation, as were anthropologists by colonial administrations before them.

But within the staff there remains a range of views that command some following. The second technique of paradigm maintenance is the internal review process. A document goes through rounds of discussions at successively higher levels of the hierarchy, each level being a filter that narrows the range of views espoused by "the Bank". It is during this review process that critics can insist upon standards of proof for non-orthodox statements that they would not ask for statements seen to be in line with the Bank's established message, and so apply pressure for non-orthodox statements to be diluted or removed. Also, managers at the higher levels are sensitive to the more "systemic" pressures for paradigm maintenance discussed earlier, and comment on a document in light of the need to respect those pressures.

Thirdly, the legions of Bank editors, some in-house, some employed as consultants, are an important part of the filtering mechanism. Their continued employment depends not only upon their ability to write clear English, but also on their ability to write copy that, being in line with "Bank thinking", will not attract criticism.

This is the mechanism for conformity. All prominent Bank documents go through it. But what issues get onto the Bank's agenda for this mechanism to be applied to? On the whole the Bank has been a reactive rather than proactive organization, taking its lead from outside. As each new issue comes to the center of the development debate the Bank ensures its own expansion and centrality by launching bids for expert status on the issue, proposing market solutions with compensatory or mitigatory elements, creating a consensus around its position,

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[41] This is based on the staff of the research complex (PRE) in 1991. Of the total 465 Higher Level Staff, 290 had graduate degrees from US universities, 74 from UK, 10 from Canada, zero from Japan. I thank Devesh Kapur for this information.

and marginalising more radical alternatives.[42] Non-Bank participants then line up "for or against" the World Bank. It might be called a Strategy for the Sustainable Development of the World Bank.

The East Asian Miracle can be read as the latest expression of this strategy. East Asia and industrial policy came to center stage in the late 1980s, as the US and European economies continued to limp and East Asian economies continued to soar. The new element in the situation, compared to, say, a report on Africa or the Bank's poverty work in the 1980s, is that the number two shareholder was putting pressure on the Bank to endorse, or at least make some concession to, its non-orthodox views about development principles. The mere centrality of the issue in the development debate would not have been sufficient to prompt the Bank to make a special study, for the issue was at once too indirectly tied to lending and too likely to complicate the established policy formula.[43] But by this time Japan had become too important for its views to be ignored.

This made it important to choose a team leader known to be solidly in the mainstream of Bank thinking, not a doctrinaire free marketeer. John Page--student of Ian Little's, protégé of Anne Krueger's,[44] but subsequently of more pragmatic views--met this

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[42] Peter Gibbon, 1993, "The World Bank and the new politics of aid", *European Journal of Development Research*, 5(1), June, 35-62.

[43] I worked in the Bank's Trade Policy division in 1987-88, at the time when a team from the division was formulating a paper setting out the Bank's trade policy and its empirical and conceptual underpinnings. As a member of the same small division, I urged the team repeatedly to examine East Asia's import control regime, and especially to consider whether the regime contained design features that enabled Japan, Korea, and Taiwan (all three heavily protected economies for long periods) to escape some of the expected neo-classical costs. I indicated possible mechanisms (as in Wade, 19993, "Managing trade: Taiwan and South Korea as challenges to economics and political science", *Comparative Politics* vol. 25, n. 2, pp.147-167; and 1991, "How to protect exports from protection: Taiwan's duty drawback scheme", *The World Economy*, vol. 14, September, pp.299-310), and offered to provide relevant literature. To no avail. The team was unwilling even to consider the possibility that protection East Asian style might have brought some benefits as well as costs, and the trade policy paper refers to the import control regimes in East Asia only in terms of their liberalization. See *"Strengthening trade policy reform"*, 1989, Washington DC, World Bank, November.

[44] Ian Little was professor of economics at Oxford University, Anne Krueger was World Bank vice president for research, and both are well known conservative economists. See for example Little, 1982, *Economic Development: Theory, Policy and International Relations*, New York: Basic Books.

condition. Likely candidates from the East Asia vice presidency did not. On the other hand, the universalistic and non-institutional ethos of neo-classical economics meant that no premium was given to selecting people for the core team with some prior expertise in East Asia (whether Bank staff or consultants). Any Bank economist is expected to be able to become an expert on a particular country within months.

The East Asia vice presidency was excluded. True, it got the country studies; but the short deadline and the small budget for the country studies meant that they had to be based on already conducted research, and in any case the core team largely ignored them. On the other hand, East Asia could not be prevented from being the major reviewer. The question was how much had to be conceded to its views in order to avoid its de facto veto on the appearance of the study.

Let us see how the final document shows these cross-pressures.

The document concedes to the Japanese position the *fact* of extensive government intervention in most of East Asia, for the first time in a major Bank publication. It also grants the argument that some of these interventions, in the areas of exports and credit, may have fostered growth and equity in some parts of East Asia. These concessions came after a battle within the Bank between the core team on the one side and large numbers of Bank economists and managers on the other, especially those from the East Asia vice presidency. It is likely that the outcome was influenced by the fact that the Japanese sponsors were known to want the Bank to admit that some kinds of interventions could be effective.

The President of the Bank is the one who ultimately must keep the main shareholders happy. It is no accident that Lewis Preston's seven paragraph preface sets a tone that is closer to the Japanese position than the bulk of the report is. Drafted within the core team, it did not have to fight its way up the approval hierarchy. "This diversity of [East Asian] experience", it says, "reinforces the view that economic policies and policy advice must be country-specific, if they are to be effective". "The report also breaks some new ground. It concludes that in some economies, mainly those in Northeast Asia, *some selective interventions contributed to growth*, and it advances our understanding of the conditions required for interventions to succeed....These prerequisites suggest that the institutional context within which policies are implemented is as important to their success or failure as the policies themselves" (p. vi, emphasis added).

Despite all the pressures for the Bank not to admit it has been wrong, here the President of the Bank hints at just that. A cynic might say that the "some selective interventions contributed to growth" statement by Preston, plus the line in the text that says "other directed-credit programs also may have increased investment and generated important spillovers" (p.356), are what the Japanese paid $1.2 million for.

But the undogmatic stance seen here is not found in most of the main body of the report as it emerged from the hierarchical review process. Here we get "[I]ndustrial policies were largely ineffective" (p.312), and "promotion of specific industries generally did not work" (p.354). Several rhetorical devices help to secure these paradigm-protecting conclusions.

First, the argument deploys the familiar rhetorical device of the triptych, comprising two extremes and a sensible middle, our confidence in the truth of the middle intended to be boosted by the foolishness of what it is not. In the *Miracle* we are presented with two cartoonishly extreme interpretations of East Asian success--laissez faire and government intervention--and then with the sensible sounding "market-friendly" approach. This was, however, a late addition. Together with the removal of "strategy" and "strategic", it was part of the price of acquiescence from the East Asian vice presidency.

Second (really an extension of the first), the report seeks to persuade by ignoring serious alternative explanations of East Asian economic success. The main alternatives to "market friendly policies plus export push policies yield export-led growth" are not "laissez faire" or "government intervention". Indeed, no serious scholar has argued that the difference between East Asia and elsewhere is to be explained mainly in terms of government intervention. The main alternative, rather, is "favorable initial conditions (especially human capital and infrastructure) plus investment-led growth". In this explanation, exports are more the result of fast growth than the cause. The causality runs from higher investment to faster technical change and higher imports, and from these to higher exports.[45] Sectoral

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[45] See Dani Rodrik, 1994, "Getting interventions right: how South Korea and Taiwan grew rich", mimeo, Economics Department, Colombia University; UNCTAD, 1994, "The visible hand and the industrialization of East Asia", *Trade and Development Report*; and Robert Wade, 1990, *Governing the Market*, Princeton University Press, p.47-8, chapters 6 and 9.

industrial policies enter the explanation as an important cause of high rates of aggregate investment, as well as a cause of the structure of that investment. The policies helped East Asia to move quickly from the "factor-cost" driven stage of competitiveness to the "investment" driven stage.[46] Of course the report notes the fact of unusually high investment in East Asia, but sees it as more a result of market friendly policies and export push than as itself the primary proximate driver--without doing any of the obvious econometric tests to examine the causality. It fails to address the evidence that export growth was more the result of rapid GDP growth than the cause--evidence such as that which led Irene Trella and John Whalley to conclude, "the results seem to imply that outward-oriented policies in Korea have little significance in driving growth".[47]

Third, the argument tries to persuade by employing asymmetrical standards of evidence. As the drafts went up the approval hierarchy, the many critics who asked "what exactly is your evidence?" were concerned only with the pro-intervention propositions. They took for granted that if the evidence is not very strong it should be discounted, but did not apply the same scrutiny to propositions in favor of the free market. *The market is innocent until proven guilty, the government is guilty until proven innocent.* So it is that the report is able to be so confident about the "market friendly" causes of East Asian success while presenting empirical evidence that does not survive scrutiny.

For example, the key proposition that more open economies grow faster than more closed ones is based on the finding that indicators of openness are positively correlated with growth in the basic growth regression. One indicator of openness is an index constructed by David Dollar. As Dani Rodrik has shown, it is really a measure of real exchange rate divergence, not of

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[46] M.E. Porter, 1990, *The Competitive Advantage of Nations.* New York. Chapter 10.

[47] Irene Trella and John Whalley, 1992, "The role of tax policy in Korea's economic growth", in T. Ito and A. Krueger (eds.), *The Political Economy of Tax Reform,* Chicago: University of Chicago Press. See also Colin Bradford, 1992, *"From trade-driven growth to growth-driven trade: reappraising the East Asian development experience"*, OECD Development Center, OECD; also Rodrik, 1994, "Getting interventions right", op.cit.. Nor does the report examine what many analysts, though few economists, consider to be central to East Asia's economic success: the "informal sector", the skeins of relational networks that operate behind the apparently formal institutions of finance, business and government across the region.

openness.[48] But if used as an index of openness, Dollars' own published results say that Japan and Taiwan were *less open* during 1976-1985 than Argentina, Brazil, India, Mexico, the Philippines, and Turkey--a result that the Miracle study does not use! Rodrik concludes that the evidence presented for the proposition that more open economies grow faster is simply not relevant. To the extent that it is, it points the other way.

Again, the report says that "price distortions were mild" (p.24), or that "East Asia's relative prices of traded goods were closer on average to international prices than other developing areas" (p.301). This generalization is important for the argument that while industrial policies existed in East Asia, their magnitude was slight. But the report also acknowledges that the relative prices of Japan, Korea, and Taiwan deviated *more* from international prices than those of such notorious interventionists as India, Pakistan, Brazil, Mexico, and Venezuela in 1976-85 (p.301). The report's conclusion reflects the *average* price distortions of all eight East Asian cases, including the city-states of Hong Kong and Singapore.

Take again the way the report treats its own evidence on the effectiveness or otherwise of sector-specific industrial promotion. One of the tests concerns the correlation between growth in output or value added by different industries, and the level of wages or value added per worker in the same industries.[49] If sectoral industrial policies made a difference, the argument runs, we expect a positive correlation, because industrial policies aim to favor capital- and technology-intensive industries, and these factor intensities are proxied by high wages. So if industries that grow faster also have higher wages, this means that the more capital- or technology-intensive industries are growing faster, and industrial policies can be declared successful. Conversely, if the correlation is negative we have grounds for concluding that structural change is driven not by industrial policy but by market forces. It can be argued that the test is misspecified.[50] But my concern here is with what the report does with its own evidence. The results for several time periods yield mostly positive correla-

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[48] Dani Rodrik, 1994, "King Kong meets Godzilla: the World Bank and the East Asian Miracle", in Miracle or Design: Lessons from the East Asian Miracle, Overseas Development Council, Washington DC, pp.13-53, at p.35-39.

[49] See *Miracle*, table A6.2.

[50] As does Rodrik, ibid.

tions (pro industrial policy) for Hong Kong, Singapore and Japan, and mostly negative ones (pro free market forces) for Taiwan and Korea. But none of the results are statistically significant--except those for Korea. The report concludes that these results confirm the *ineffectiveness* of industrial policy in East Asia.

Once standards of inference as elastic as these are allowed to leak into what we call "evidence", confirming results can be pumped out as easily as bilge water.[51] It is a fine irony that when the one person connected with the study who had work experience in Asia suggested some discussion of cultural propensities to save and educate, he was told the matter could not be discussed because of lack of evidence.

To the extent that the authors were aware of the inconsistencies and the biases in the interpretation of evidence,[52] they may have left them in an attempt to widen the grounds of debate without generating a backlash that would cause the report to be dismissed as incompetent or ideological and the Bank to be accused of changing its mind. To avoid this fate, the East Asian experience *had to be* accommodated to the reigning paradigm, with some qualifications around the edges.[53] But the qualifica-

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51 There are many other examples of dubious evidence in the report; see papers by Rodrik, Wade and Haggard in *Miracle or Design?*, op. cit., and references cited therein.

52 My argument does not imply that these techniques were deployed deliberately in an attempt to maintain the Bank's central beliefs. One does not need to embrace postmodernism to agree that people's commitment to a particular paradigm has a large subjective element (is underdetermined by the evidence), and that they are largely unaware of how the commitment is protected, by themselves and others, from contrary evidence or interpretations.

53 These pressures may explain another oddity. The Japanese were especially interested in getting the Bank to admit that directed credit had worked in Japan and elsewhere in East Asia. But the Bank is deeply committed to the view that selective industrial promotion cannot raise national welfare, and so needs to conclude that it did not do so in East Asia. Since directed credit is--it would seem--simply one instrument of selective industrial policy, the two propositions--the Japanese one about directed credit, the Bank's one about selective industrial policy--cannot both be true at the same time. Yet the report manages to imply that they are both true. It does so by classifying interventions into three ostensibly non-overlapping categories of selective industrial policies, directed credit policies, and export push policies. It concludes that the first failed, the third worked, and as for the second (the focus of Japanese interest), "Our evidence leads us to conclude that credit programs directed at exports yielded high social returns, and, in the cases of Japan and Korea, other directed-credit programs also may have increased investment and generated important spillovers" (p.356). On the face of it, this seems to be saying that in the case of Japan and Korea, directed credit was effective

tions and inconsistencies are important nevertheless. They can function as "attractor points" around which new thinking can move, they can legitimize the inclusion of new questions on the agenda of debate. This, it could be argued, is the most likely way that big organizations change their minds; sharp changes are rare.

And the Japanese have shifted the Bank enough to provide more attractor points beyond those in the *Miracle* study itself. The several studies of Japanese economic policy and civil service organization undertaken by the Bank at about the same time provide a set of policy ideas that can legitimize further work in the same domains, inside and outside the Bank; and in particular, can help legitimize the idea of "Japan as model" for use in Japan's own more dirigist Asian aid strategy, further strengthening the constituency for these ideas. It may also be argued that the Bank's softening of its stand against directed credit, as of 1995, owes something to the wider Japanese pressure on the Bank. Compared to the 1980s the Bank is now less likely to say that directed credit and interest rate subsidies should always be avoided. It is more likely to say simply that the onus must be on the proposer to explain the special circumstances that would justify directed credit in a given case.[54] The shift is small, but not trivial.

My argument raises a wider question about the Bank's research function. The organization has a unique position as a generator of numbers and explanations about development, thanks to a research budget bigger than any other development organization's and to its ability to get media coverage of its major findings all around the world. But the needs of its internal and external constituencies generate pressure for research that justifies--or does not question--the Bank's meta-policy, research that validates the "there is no alternative" to government policies that stay within the bounds of "strengthening the enabling environment for private sector development". For the same reason, the research must be largely quantitative and econometric; for numbers and econometrics carry authority in and of

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as an instrument of sectoral industrial policy. Dani Rodrik writes, "It is difficult to fathom how [such a logical inconsistency of major proportions] found its way into the report (and as a major conclusion, to boot)" (op. cit., p.28). Part of the reason is an editorial failure to make a clear distinction between two types of "directed" or "selective" policies: "functional" and "sectoral", where "functional" refers to a non-sector specific function, like R&D or exporting, and "sectoral" refers to specific sectors (chemicals, machine tools, etc.). When the text talks of "selective" industrial policy it means "sectoral" or "sector specific"; when it talks of "selective" or "directed" credit policy, however, it means "functional". Its only evidence on directed credit for other than exports comes from a study of the effects of subsidized R&D credit in Japan, that is, a study of a "functionally directed", not sectorally-directed credit policy. On the basis of this study the authors say that (functionally) directed credit worked in Japan in the sense that it had higher social returns than private returns, made a net addition to R&D investment rather than substituting for more expensive commercial credit, and was cut off when no longer needed. So the Bank's conclusion about directed or selective credit applies to functional policy, while its conclusion about selective industrial policy applies to sectorally-selective policy.

Why was such an obvious source of confusion allowed to persist? The effect of fudging the distinction between functional and sectoral was to allow readers more scope for interpreting the results in line with their prior inclinations, and in particular to allow those sympathetic to the Japanese position on credit to infer a bigger agreement with that position than was the case.

[54] And it would point out that the question cannot be debated without making several distinctions: credit may be directed by region, by urban/rural, by small firm/large firm, by sector, by sub-sector; it may contain a larger or smaller element of subsidy; the amount of subsidy may be calculated in relation to the cost of lending or in relation to the price that the lender would otherwise charge; directed credit may comprise a larger or a smaller percentage of total credit.

themselves, except among the tiny minority inclined to examine what lies behind them. Research that meets these twin characteristics helps to maximize staff commitment internally and authoritative reputation externally. But at what cost in truth?