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State Development Planning: Did it Create an East Asian Miracle?

BENJAMIN POWELL

Abstract. East Asian countries have recorded large increases in per capita GDP over the last fifty years. Some observers have referred to this growth as an "East Asian Miracle." One popular explanation attributes the rapid growth to state-led industrial development planning. This paper critically assesses the arguments surrounding state development planning and East Asia's growth. Whether the state can acquire the knowledge necessary to calculate which industries it should promote and how state development planning can deal with political incentive problems faced by planners are both examined. When we look at the development record of East Asian countries we find that to the extent development planning did exist, it could not calculate which industries would promote development, so it instead promoted industrialization. We also find that what rapid growth in living standards did occur can be better explained by free markets than state planning because, as measured in economic freedom indices, these countries were some of the most free in the world.

Key Words: East Asia, industrial planning, economic calculation, economic freedom, development planning

JEL classification: O200, O170, O530, B530, P170

East Asian countries have experienced dramatic economic development since the end of World War II. First Japan, then Taiwan, South Korea, Hong Kong, Singapore, and others, recorded large and rapid increases in per capita GDP (see Figure 1). Many attribute this success to a unique "Asian Model" of economic development (Johnson 1982, Amsden 1989, Wade 1990, Evans 1995, Stiglitz 1996, 2001, Woo-Cumings 1999). This model maintains some international market forces, but also involves heavy direction of the economy by state industrial planning agencies.

The East Asian financial crisis of the late 1990s did not change the views of those who claim East Asia's success resulted from developmental planning. In fact, Wade (1998, 2000) attributes much of the blame for the crises to departures from the state directed model.1 Stiglitz and Fuhrman (1998) and Stiglitz (1999) largely agree with Wade that rapid financial and capital market liberalization in East Asia combined with other factors to cause the crises.2 These authors still believe that state industrial planning played a major role in East Asia's success prior to the crisis.

This paper critically examines the standard account of East Asia's success by questioning whether a model of state development planning could have created East Asia's miracle development.

Economic development that enhances consumers' standard of living is not simply about industrialization. It is about creating the right industries. If state planning is to lead to higher
Wade describes the main features of development planning: "A pilot agency or economic general staff is one of the core features. The pilot agency decides which industries ought to exist and which industries are no longer needed in order to promote the industrial structure which enhances the nation's international competitiveness" (1990:195).

State development planning models typically view capital accumulation as a key for growth, but they do not view capital as a homogenous category like many neoclassical models. Advocates of development planning think that the government must direct both the level and composition of capital in the economy. Wade describes this process:

The GM theory, on the other hand, emphasizes capital accumulation as the principal general force for growth, and interprets superior East Asian performance as the result of a level and composition of investment different from what the FM [Free Market] or SM [Stimulated Market] policies would have produced" (Wade 1990:29).

What capital should be accumulated to produce the greatest increases in well-being? Those who advocate state development planning must answer this central question. Wade and others believe that government development planning bureaus, such as MITI in Japan, can better answer the question than a free market entrepreneurial process.

2. Problems Confronting State Planning

The profit and loss system informed by market prices serves as a guide to direct which industries should expand and which should contract in a market economy. Advocates of state development planning must answer how the agencies will have knowledge superior to the unhampered market and once they have it, how it will remain in the planners' interest to promote only those industries that best promote growth. The first problem will be referred to as the knowledge or calculation problem, while the second will be referred to as the public choice incentive problem. Although advocates of East Asian state development planning address the second incentive problem, they fundamentally misconstrue the nature of the knowledge problem.

2.1. The Knowledge Problem

A comprehensively planned rational economy is impossible. Mises (1920, 1949) showed that without private property in the means of production, prices for the means of production could not exist. Without prices, there are no relative scarcity indicators, and rational economic calculation is impossible. Hayek (1933, 1940) also stressed the role of the market process in generating the knowledge necessary to have an efficiently functioning economy. Hayek stressed the tacit and inarticulate knowledge that individuals possess that cannot be communicated to the central planners. With decentralized individual planning in the market, this information is used by actors while only passing on relevant information to others through actions that generate market prices (1945). Hayek shows how the market itself is the "discovery procedure" that finds new patterns of economic production that best satisfy consumer wants (1978).
Project that was not profitable when it was undertaken and subsidized by the government is eventually profitable does not indicate that it should have been undertaken when it was. For example, an electric toaster industry in the late 19th century U.S. could have been subsidized and created by state interventions. It would not have been profitable until at least the 1930s when more homes had electricity. Would the state have been correct for subsidizing the industry for more than thirty years? There is some relevant time frame, prior to profitability, that an industry should be created, but not too long before. The state bureaux are unable to answer how long because they cannot evaluate the opportunity cost of resources they divert.

The market can determine how far ahead a project should be undertaken. Wade often accuses the market of short-sightedness, writing things such as, "Lumpy and long-term investment projects were undertaken which would probably not have been undertaken in an economy with free trade and capital movements, because they would not have been consistent with short-term profit maximization" (1990:344). Businesses do not focus on only short-term profit maximization. All the time they undertake long-term projects that will not be profitable for years, but they undertake them because the expected future value of those profits more than offset the temporary losses. Entrepreneurs discount future profits to account for this by doing net present value calculations. They also make adjustments for the uncertainty that the future project might not be successful because of changed circumstances.

It is not a sign of inefficiency that these factors cause individuals in the market not to undertake projects that the government could create through development subsidies. Time preference is a universal feature of human action, and the fact that it decreases the value of things that will only be profitable in the future does not negatively affect our level of well-being. When the government forces projects to be undertaken that would not have happened in the market because of time preference, society becomes worse off because resources for projects that could have satisfied more immediate desires are unavailable.

A government subsidized industry that eventually becomes profitable does not prove the success of the subsidy. Planners would need to know the time preference rates of consumers whose wants were not satisfied and the opportunity cost of the resources taken from other projects to subsidize the favored industry to make this claim. This data does not exist outside the very market process that the subsidies subverted. No method exists to evaluate if an industry subsidy added value to society.

The most fundamental error in the governed market's approach to solving the knowledge problem is conceiving of it as a "technical" or "engineering" problem. Wade wrote, "Investment choice has been influenced by essentially engineering concepts of take-off, linkages, gaps, substitutions, and incremental extensions—conceived in the first instance in physical rather than value terms. This reflects the importance of engineers in the planning process" (1990:188). But "value terms" create the knowledge problem.

Mises (1949) showed that technological knowledge provided by engineers only serves as a method of choosing production methods if either each factor of production is absolutely specific or all factors were perfectly substitutable for each other. If either of these conditions holds, once consumer desires were known, the production problem would become an engineering one. But in the real world neither of these conditions is true.
Lavoie (1985) illustrates the problem by asking the reader to consider wood, which is nonspecific—it could be used for building houses or making paper. How do we choose the combination of uses that would best satisfy the demands for reading and shelter? "This is not an issue about which the engineer has any special expertise. It is not a question to which quantitative measurement of any physical dimension is relevant. It is a question of the relative value of wood in alternative uses" (1985:53). Considering only engineering concepts and technical feasibility misses the economic question of how to employ means to achieve ends such that no other more urgently felt want goes unsatisfied. Focusing state development programs on engineering concepts does not avoid the economic problem—it ignores it. To promote real increases in standards of living, the economic problem must be solved.

Advocates of development planning sometimes deny that a knowledge problem needs to be solved. Wade asserts that the "correct" industries corresponding to a country's comparative advantage are not just out there to be found, but can be made. He writes, "'Picking Winners' implies that the potentially competitive industries are out there waiting to be discovered, as though the problem is to find those that most closely correspond with the economy's given comparative advantage. The governments of Taiwan, Korea, and Japan have not so much picked winners as made them" (1990:334). If a state provides a large enough subsidy, an industry can be created that would not otherwise exist. Path dependencies and positive externalities develop within the industry that may later allow it to survive without subsidy. Because the industry can later survive does not mean that development was promoted, however. Some other industry that better corresponds to the country's comparative advantage would have developed in absence of the subsidy. Real resources are used that could have better satisfied consumer wants in other industries. Krugman makes the point clear, writing, "You can't promote all domestic industries; by subsidizing one, you help it bid capital and labor away from others. So a strategic trade policy on behalf of some industries is in effect a strategic policy against others" (Krugman 1994:242). Winners must be picked, and that implies the state also must pick losers. All industrial policy decisions impose costs.

Some have suggested that "smart" people are necessary to overcome the problems planning faces. Even if the planners are the most brilliant people in the country, they still cannot make the right calculations necessary to determine which industries should be promoted. The problem is not that someone is not smart enough, but that the relevant information is not given to any one mind. The knowledge is dispersed over all of the individuals in society and is only produced via the market process. Any attempt to go beyond the market's process simply does not have the relevant information available. Lavoie summarizes the problem by writing,

To propose that the planning agency guide and accelerate market forces is to presume that the investment-guiding agency can anticipate future developments better than the market can; it is to assume that the agency's individual intelligence exceeds the social intelligence of the competitive process. How will the investment-guiding agency know exactly which up-and-coming firms to direct funding toward? (1985:186).

The outcome of the market process is the only way to answer the economic question of which industries should be promoted, regardless of how intelligent the planners might be.

STATE DEVELOPMENT PLANNING

There is evidence of planning bureaus' failures in East Asia to consistently pick winners. Some of East Asia's most successful companies were discouraged by government planning agencies and other large companies that were supported consistently failed to become profitable. When Sony was only a small electronics firm in the early 1950s they needed government permission in order to get the rights to manufacture transistors from Western Electric. MITI refused arguing that the technology was not impressive enough and it took Sony over two years before they were eventually able to persuade MITI to allow them to obtain the rights (Henderson: 1993). Of course Sony went on to become an extremely successful international business despite MITI's discouragement. In the mid fifties MITI tried to make the auto industry produce a prototype "people's" automobile so it could choose the winning firm and make it the single producer (Henderson: 1993). Then later in the 1960s MITI attempted to prevent auto manufacturers from entering the export market and then attempted to force ten auto firms to merge into Nissan and Toyota (Lavoe 1985:195). Luckily the Japanese auto firms resisted all of these interventions and went on to become one of Japan's most successful industries. Korea provides an example where the government cannot intervene in order to create a winner in the ship building industry. The government gave large subsidies to both Korean companies so that they could compete with large shipbuilders in the foreign market. Yet the industry needs periodic bailouts to stay in business. (Choi 1994:241).

Although the market can demonstrate failures of development planning, its not possible to identify successes. Henderson (1993) writes,

Between 1953 and 1955 MITI did persuade the government's Japanese Development Bank to lend money to four industries—electric power, ships, coal, and steel. Some 83 percent of JDB financing over that period went to those four industries. But even with hindsight, what has not been established is whether those were good investments.

The calculation and knowledge problem implies that we can never determine that they were good investments for theoretical reasons. We can point to evidence of failures in calculation, because firms demonstrate they should exist as structured by succeeding in the free market despite discouragement by the government or when firms continue subsidized by the government fail to become privately profitable. In both cases feedback from the market indicates a knowledge failure on the part of the planners. Successful planning, however, cannot ever be established by observing that a subsidized firm eventually becomes privately profitable. No market feedback mechanism is in place to show that the gain in the subsidized industry is greater than the opportunity cost of the industry that would have developed in the subsidy's absence. Although observing failures in development planning illustrates the knowledge problem, there is no way to establish which of the industries that are apparent "successes" should have been created, so they are not ever proof of planning's success.

Advoates of development planning must establish how agencies acquire the knowledge to plan on theoretical grounds. Lessons from the socialist calculation debate show that the market process is necessary to generate the relevant knowledge for economic calculation. Attempts to guide the market through selective state development planning suffer from the same knowledge problem that socialist planners do. Gaining the knowledge necessary to direct the economy is impossible before the market process produces it. All attempts to
STATE DEVELOPMENT PLANNING

2.2. Public Choice Incentive Problem

Why would state development planners only subsidize industries that best promote growth even if they could figure out which industries they were? Buchanan and Tullock (1962) advanced the idea that politicians should be modeled as rational self-interested individuals who respond to incentives. Olson (1965) further showed that the logic of interest group pressure causes these self-interested politicians to concentrate benefits in the hands of a few while dispersing costs over the general population. Why would state development planning bureaus promote growth, a general interest, while ignoring political incentives that encourage them to concentrate benefits on the most politically beneficial industries?21

Wade (1990) attributes East Asia’s success in overcoming the incentive problem to the fact that East Asian states are relatively centralized and insulated from society or “hard.”22 Hard states are created by a number of factors, some of which were present in many of the East Asian countries during their development.23 In particular, most states had experienced large social dislocation, which breaks up organized interests groups and allows the state to focus on promoting more encompassing interests (Olson 1982). Through Japanese occupation and then allied victory, World War II caused this type of reorganization of interests in most East Asian countries. Dislocation may have helped East Asian countries to overcome both general forms of rent seeking behavior and also those associated with state development planning.24 Wade focuses on the formation of encompassing interests, saying,

By constructing corporatist political arrangements before interest groups began to gain or regain strength, they could channel and restrain demands placed upon the state as those demands grew. One great advantage of corporatist arrangements is that the demands emanate from relatively homogeneous organizations, whose memberships are made up of a sizable portion of the whole society. They are therefore constrained in the extent to which they use their power to urge measures which benefit their members at the expense of national income and productivity (1990:339).

Favorable conditions present in East Asia for a period of time may have minimized rent seeking, but it does not mean rent seeking was entirely eliminated or that favorable conditions will exist perpetually. In some East Asian countries these interest group problems have been becoming more evident in recent years. Although Naka (1994, 2002), attributes much of Japan’s success to lack of narrow interest groups in post war years, during the 1990s recession, repeated fiscal stimulus packages have focused on the construction industry, one of the ruling liberal democratic party’s closest supporters (Powell 2002).

Rent seeking also occurred in Korea. As much as 10 percent of all foreign loans were kept by President Park’s government for personal and political uses (Choi 1994:240). Choi also found that the pricing of foreign capital goods was between 20 percent and 100 percent higher in public projects than the norm, and the difference was kicked back to key figures in the ruling party (1994:240-241). Evidence also suggests that owners of big business bribed government officials to get access to government rationed credit that was priced well below market rates. Also, while there was high inflation during the 1960s and 1970s the government forced citizens to buy long-term bonds while giving low or 0 percent interest rates on loans to favored businessmen (Choi 1994:241, 250). Choi summarized the rent seeking activity in Korea, writing “It is not that South Koreans avoided rent seeking, but that the dominant group monopolized it, claiming the lion’s share of the gains from economic growth” (1994:249). Although monopolized rent seeking may lead to a longer time horizon for rulers and better promote development than decentralizes rent seeking, Korea illustrates that even relatively “hard” states are not immune from rent seeking inefficiencies when they engage in industrial development planning.

Although favorable conditions may have minimized incentive problems facing state development planning agencies at a period of time, the problem was not entirely eliminated and meaningful development was not promoted by state planning agencies. We have seen that state planning bureaus are unable to overcome the knowledge problem.25 This should make us skeptical that state development planning was responsible for the East Asian development miracle.

3. Evidence from East Asia

East Asian countries have experienced dramatic increases in their standard of living. Figure 1 shows large improvements in levels of per capita income during the past 25 years. Johnson (1982), Amsden (1989), and Wade (1990) have documented that some state development planning occurred in Japan, Korea, and Taiwan. Stiglitz is correct when he writes, “The controversy surrounds two questions—the counterfactual and the aggregative quantitative significance of these interventions” (2001:518). We must determine to what extent the planning actually interfered with market forces—the quantitative—and to what extent these East Asian countries could have developed without state planning—the counterfactual.

To the extent that state development planning existed, we have shown that it cannot utilize the knowledge that the free market can in solving the economic problem of growth that satisfies consumers’ subjective wants. The technical knowledge generated by engineers is useless for solving the economic problem. Technical knowledge can be used to promote industrialization, the creation of factories and products, though they will not correspond to satisfaction of consumers’ most urgent wants.

3.1. Industrialization or Development

Real economic development consists of the ability to satisfy greater levels of consumers’ subjective wants. Unfortunately, no single and objective way exists to measure consumer subjective want satisfaction. Imperfect proxies exist, the best of which focus on consumers’ standards of living.

Wade’s (1990) data indicating the success of industrial policy in East Asian countries focuses on industry output data instead of measures of consumer welfare. Wade (1990), following Johnson (1982), writes, “The top priority of state action, consistently maintained,
in economic development, defined for policy purposes in terms of growth, productivity, and competitiveness rather than in terms of welfare" (p. 25). This type of data does not actually measure success in solving the economic problem. It indicates how well the state has solved particular technical problems, such as much steel was produced, without regard for the opportunity cost in consumer welfare. Measures show that consumers' standard of living in East Asia have improved over the last fifty years. They also indicate that other measures, less focused on consumer welfare, may overstate the amount of development-East Asia achieved.

Japan's GDP per capita statistics are one example of how development can be overstated. Many industrial policies in East Asia have placed tariffs on imports, raising the price of consumer goods in their home country to promote the development of businesses. But tariffs also limit the well-being of the average consumer in the society. When income levels are adjusted for purchasing power differences, caused in part by the industrial policies themselves, consumers' standard of living can be much lower. In Japan's case, GDP per capita was $37,522 in 2000, but when the figure is adjusted for purchasing power it falls to $25,280 (World Bank 2003). Figures that fail to adjust for purchasing power parity in Japan overstate the level of consumer well-being by more than 40 percent.

Another way to measure consumer welfare is to look at what people own. Assuming Asians have similar tastes and preferences for goods as consumers in the U.S., we would expect the difference in ownership rates of goods to be approximately proportional to the difference in GDP per capita. World Bank data shows that ownership rates for televisions, radios, and automobiles are lower in some East Asian countries than is predicted by the difference in their GDP compared to the U.S. While Japan's GDP per capita is reported as 140.6 percent of the U.S. GDP per capita in 2000, Japanese citizens own about 45.1 percent of the number of radios per person and 84.9 percent of the number of televisions per person (World Bank 2003). Table 1 reports similar findings for other East Asian countries over the past 20 years. Although lower automobile ownership rates make sense in some East Asian countries, such as small island nations like Hong Kong, why television and radio ownership rates are lower is less obvious. This type of data indicates that some of the "development" in these countries may not translate into increases in consumer well-being.

Industrial planning can solve the technical problem of increasing output, but not the economic problem of only increasing output where consumers most urgently want it without leaving other more urgent wants left unsatisfied. Industrial planning drives a wedge between measured increases in output and actual consumers' standard of living. The anecdotal evidence above suggests that this happened to some extent in East Asia. This is not to say that a dramatic increase in well-being has not occurred; much evidence suggests it has. This only indicates that the industrial planning present has decreased consumers' standard of living to some extent.

### 3.2. Economic Freedom or Planning

Little doubt exists that East Asian countries' standards of living have increased despite the difficulty of measuring consumer subjective well satisfaction. An important question is how pervasive government planning was in these economies. If we find that while some state planning existed, on balance East Asia countries relied more on markets, were more free economically, and had stronger private property rights than other slower growing areas of the world, we can explain East Asia's growth despite the existence of some state planning.

Table 1 reports GDP and consumer goods ownership as a percent of U.S. rates.

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP (%)</th>
<th>Radio (%)</th>
<th>TV (%)</th>
<th>Car (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>53.8</td>
<td>25.3</td>
<td>39.3</td>
<td>7.6</td>
</tr>
<tr>
<td>Japan</td>
<td>134.7</td>
<td>33.9</td>
<td>95.7</td>
<td>37.8</td>
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<tr>
<td>Korea</td>
<td>18.6</td>
<td>47.2</td>
<td>29.4</td>
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</tr>
<tr>
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<td>18.6</td>
<td>55.3</td>
<td>12.2</td>
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<td>72.0</td>
<td>31.4</td>
<td>36.5</td>
<td>7.3</td>
</tr>
<tr>
<td>Japan</td>
<td>122.8</td>
<td>42.4</td>
<td>79.1</td>
<td>49.4</td>
</tr>
<tr>
<td>Korea</td>
<td>30.5</td>
<td>41.7</td>
<td>27.1</td>
<td>8.4</td>
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<tr>
<td>Singapore</td>
<td>67.4</td>
<td>22.5</td>
<td>44.0</td>
<td>15.6</td>
</tr>
<tr>
<td>Hong Kong</td>
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<td>32.3</td>
<td>57.8</td>
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<tr>
<td>Japan</td>
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<td>45.1</td>
<td>84.9</td>
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<tr>
<td>Korea</td>
<td>41.5</td>
<td>48.8</td>
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<tr>
<td>Singapore</td>
<td>89.4</td>
<td>31.7</td>
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Wade correctly points out that, "The key question is what has determined the level and composition of investment in these countries. There are plenty of facts about Taiwan, Korea, and Japan which do not fit the neoclassical FM and SM theories than the political economy GM theory." But he further writes, "But it is clear both that less economic liberalization occurred in the 1960s and 1970s than neoclassical accounts suggest, and that much government intervention has gone beyond the limits of "good" neoclassical interventions. Government resources and influence have prompted investments to be undertaken which would not have been undertaken in strictly FM or SM conditions" (1990:342). We need to determine if while the governments were doing some things to affect investment, they also left more room for the market to operate than governments in other industrialized nations. Wade dismisses the argument that the countries grew in spite of the planning, writing.

The balance of presumption must be that economic liberalization matters less in an explanation of East Asian success than neoclassical accounts suggest, and that actual performance was better than it would have been with WM or SM policies alone. But we should reject the unargued assertion that "without MITI Japan would have grown at 15 percent per annum" instead of only 10 percent; or that for Korea, "success has been achieved despite intervention." It is less plausible to say that the three countries with arguably the best development performance on record would have had still better
performance had their governments intervened less, than to say that interventions made with the clear intention of accelerating development and formulated by a coherent organization did indeed have the intended effect. Those who deny this are claiming extraordinary ability to forecast historically unprecedented performance (1990:342-343).

Wade can make this claim only because he fails to consider that these East Asian countries might have had industrial planning simultaneously with still freer economies than other counties in the world. Hong Kong is particularly troubling for those who claim state development planning caused East Asian growth. Hong Kong is typically held up as an example of a textbook free market capitalist economy. Wade writes, "The Hong Kong case does not support the proposition that because Hong Kong did as well as the others without industrial policies, the industrial policies of the others could not have made much difference" (1990:343). Wade dedicates two and a half pages to proving that Hong Kong is not a free market economy. He writes,

It is true that the formal institutions of government perform mainly custodial functions and that Hong Kong has no controls over imports, foreign exchange, foreign investment, and wages and prices. Tax revenues to GNP are very low, at 13.7 percent in 1977, compared to Taiwan's 24.2 percent. But to conclude from this that Hong Kong is close to a free market economy is misleading (1990:331-332).

The one paragraph of evidence supporting this case mentions revenue raised through government granted leases, control of the housing market through a large amount of public housing, and immigration control manipulation. This makes Hong Kong less than a perfect capitalist country. It does not mean that Hong Kong is far from a totally free market economy. In fact, the Fraser Institute's Economic Freedom of the World Annual Report has ranked Hong Kong the most economically free country in the world from 1970 to present.

Although one cannot accurately claim that Hong Kong did not grow, or that it was not an example of a free market economy, that does not prove that the development in other East Asian countries did not occur because of state planning. After all, Hong Kong is a small nation and other regional effects may have influenced its growth.

The most troubling fact for theories that claim East Asian development occurred because development planning is that the very economies that are supposed to be examples of state planning are some of the most free market economies in the world. Wade (1990) specifically says that to look at only government as a percent of GDP to determine the level of government activity in the economy is not enough. Just because a country may have a low percent of GDP consumed by government, regulators could be severely affecting market outcomes. The Economic Freedom of the World annual report, although an imperfect measure, is the best overall measure of government interference and direction of the economy available. This broad index covers five major areas of the economy, including size of government: expenditures, taxes and enterprises; legal structure and property rights; sound money; freedom to trade with foreigners; and regulation of credit, labor and business. These five major areas are made up of 21 components and 37 distinct pieces of data.

Wade's (1990) evidence that East Asian countries were cases of state led development focuses on the ways the governments interfered with their economies. Equally important evidence from all of these economies is what their governments did not interfere with. Looking at the Economic Freedom of the World report allows us to determine whether the overall industrial structures in these countries were more influenced by free markets or state interference.

The Economic Freedom of the World holds all countries to the same standards when measuring freedom. It could be that because of faction and a heterogeneous population, some countries are not able to achieve as high of a level of freedom as others and that what is observed as government interference in the economy could actually be preventing further fighting between factions that would result in even less freedom. Naka (2003) shows post WWII Japan as an example of this. He shows that there was a large rural and agricultural faction that could have benefited by exploiting the more business oriented elite minority. He argues the two groups reached a Coasian bargain where subsidies through the political process were given to the rural majority in exchange for their not seizing the minority's wealth in a one shot taking. The deal promoted economic growth, benefited both parties, and possibly prevented more violent or decentralized clashes between factions that could have resulted in less freedom. Despite this, such subsidies would adversely impact measured freedom. This does not however undermine the argument the economic freedom promotes growth. It simply shows that some countries were achieving the highest level of freedom they could, given the politics and demographics in their country. If they could achieve more freedom, they could grow even faster.

Using the Economic Freedom of the World report, we find that Johnson (1982), Amsden (1989), and Wade's (1990), own examples of countries in which state development planning was responsible for growth rank very high in economic freedom. In 1970 Japan was ranked the seventh most free country in the world, Taiwan was the sixteenth freest, and even Korea was in the top 20 percent, ranking thirty-first. Other high growth East Asian countries such as Hong Kong and Singapore have also ranked near the top of the index from its beginning in 1970 to present (See Table 2).

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<td>5.0(48)</td>
<td>5.0(66)</td>
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<td>Japan</td>
<td>7.2(7)</td>
<td>6.4(14)</td>
<td>6.9(10)</td>
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<td>Korea, Rep.</td>
<td>5.9(31)</td>
<td>5.3(41)</td>
<td>5.7(37)</td>
<td>5.8(38)</td>
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<td>7.0(38)</td>
</tr>
<tr>
<td>Malaysia</td>
<td>6.5(18)</td>
<td>6.3(15)</td>
<td>6.9(10)</td>
<td>7.0(13)</td>
<td>7.2(10)</td>
<td>7.3(18)</td>
<td>6.7(51)</td>
</tr>
<tr>
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<td>7.1(7)</td>
<td>7.4(5)</td>
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<td>8.7(2)</td>
<td>8.6(2)</td>
</tr>
<tr>
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<td>5.6(29)</td>
<td>6.4(17)</td>
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<td>7.1(25)</td>
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<tr>
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4. Conclusion

State development planning cannot promote real economic growth. Advocates of development planning fail to recognize that the same calculation problem that Mises and Hayek outlined in the socialist calculation debate also applies to more limited attempts at planning the market process. The knowledge necessary for solving the economic problem of how to satisfy the most urgently felt wants without leaving any more urgent want unsatisfied requires the price knowledge that the market generates. Any attempt to "guide" the market operates without this knowledge. The technical types of knowledge Wade (1990) addresses are simply not adequate to solve the economic problem confronting development planners.

East Asia’s experience is consistent with this view. Although some state development planning did exist in East Asian countries, it was not responsible for the growth that occurred. To the extent that governments interfered with the market’s process, they promoted industrialization, not consumer-satisfying development. Although Wade (1990) points to various increases in measures such as exports, steel production, and automobile production, measures that focus on consumer well-being show that growth might be overstated. While real GDP per capita increased greatly, when we adjust for purchasing power, consumer goods ownership, standards of living are lower.

Authors who attribute East Asia’s success to developmental planning overlook important data. Although some state industrial planning did exist in East Asian countries, when these countries were growing they were some of the free market in the world. Hong Kong and Singapore are consistently ranked the top two freest countries in the world, and in 1970, when Japan and Taiwan were growing quickly, they were ranked seventh and sixteenth. Even Korea ranked in the top 20 percent. Although state development planning did exist in these countries, overall broader measures of the market’s relative sphere of influence in these countries show that they were far more market oriented than slower growing areas of the world.

To the extent that the development of the East Asian countries was a miracle, it was because the free market was the driving force. Some external factors, such as lower initial GDP and social dislocation to break up entrenched interests, certainly have had additional positive effects. The evidence from East Asia is consistent with the view that development is promoted through free markets and not state industrial development planning.

Acknowledgment

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Notes

1. Wade wrote, "Had the governments not abandoned some basic principles of the East Asian model—above all, the principle of strategic rather than open-ended integration into world financial markets—the economies
would probably not have experienced a serious crisis, although they would have grown more slowly" (2001: 167).

12. European and Stiglitz wrote, "We argue that one of the most important developments was the rapid liberalization of financial markets, both domestic and international, without the corresponding development of proper regulation or supervision" (1999:8). Wade similarly states, "Asian governments are deeply implicated in not only the capital flows into and out of the region, but also in the build-up of effective rule-based (rather than relationship-based) governance of financial markets" (2000:197).

13. In 1976, Smith recognized this point more than 200 years ago when he wrote, "Consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to, not only so far as is necessary for promoting that of the consumer" (1776:715).

14. Again Smith (1776:715) anticipates this problem, writing, "It cannot be very difficult to determine who have been the creators of this whole mercantile system; not the consumers, we may believe, whose interest has been entirely neglected; but the producers, whose interest has been so carefully attended to; and among this last class our merchants and manufacturers have been by far the principal architects."

15. Advocates of development planning insist on the link between the informational argument against socialism and how it begins, they actually get the argument backward. Vannstein (1999) indexes Stigler's, "Who's Socializing?" (1964) and writes, "A more detailed understanding of economic mechanisms and information economics has contributed the feasibility of comprehensive central planning and public ownership as viable economic strategies, the emphasis on the most interesting modern economics making it is not clear how that makes the economy more appealing than it used to be." (1999:26). Similar, Stigler (1996) characterizes American business managers as "short-term profit maximizers". Stigler (1996) takes a different angle on the problem, granting longer time horizons to managers but without changing the capital market imperfection, locking them in the short run in order to gain more profits later (1996). He does not say how government is able to identify which of these projects should be funded.

7. The charge that businesses are "short-term profit maximizers" is particularly odd since Wade and others offer evidence or argument to prove the charge and it is at odds with standard economic theory. Throughout standard economic theory, business is regarded as long-term profit maximizing. Meanwhile, from short-run shut down conditions to why private ownership is good for natural resources economics. If businesses were in fact short-term maximizers, hardly any would be so at all, since must lose money quickly. In fact, short-term maximizing at the expense of long-run optimality is usually attributed to the political process, and in the Japanese context particularly to the influence of special interest groups on the political process. (2001:715).

8. Stigler, similarly, says, "The critics of industrial policies in misguided attempts to pick winners ignore the wider range of government actions, such as its role in promoting the expansion of certain manufacturing sectors. "Picking winners" seems to imply culling from a fixed pool of applicants to find those with the highest long-run social returns. East Asian governments have instead performed an entrepreneurial role" (1999:162). Sure enough, even in an entrepreneurial role, when one industry is expanded and government suffering (p. 292).

9. Svein Stiglitz seems to imply culling from a fixed pool of applicants to find those with the highest long-run social returns. East Asian governments have instead performed an entrepreneurial role" (1995:12). Writing on the internal organization of development states, says, "highly selective meritocratic recruitment" is used.

10. Although the focus of this paper is East Asia, development planning has failed in many other regions of the world. For evidence of the failure of development planning, when one industry is expanded and government suffering (p. 292).

11. Stigler argues of state development planning recognize this problem. Johnson (1999:48) writes, "The real objection to its [state planning]'s role as an alternative to or displacement of market forces but that it is more commonly used to promote various social objectives. Of course, the expansion of certain manufacturing sectors that are static create incentives in a way that will solve the problem and cites Japan as an example."

12. The shortest answer to why this type of failure is limited to East Asia is that East Asian states are relatively weak. The position of a state in relation to its society can be thought of as varying along a continuum from decentralized and constrained by social groups, to centralized and relatively insulated from society—from "soft to hard." (Wade 1990:335). Evans (1995) deals with the interest group problem differently; he focuses on "embedded autonomy." The bureaucracy must be "embedded in a concrete set of social ties that are not only the ones that exist in the society and provide institutionalized channels for the coordination and legitimation of groups and policies" (1995:12). But similar to Wade (1990), he must also be autonomous so that they are not captured by interest groups. "Either side of the combination by itself would not work" (1995:12).

13. These factors include: massive social dislocation occurring within the past 50 years; the existence of serious military threat; support for the internal state system for a concentration of social control in the hands of the state; the existence of a social grouping with people sufficiently independent of existing bases of social control and sufficiently enough to execute the grand designs of state leaders; and skilled leaders whose ideology favors strong state control (Wade 1990:339).

14. In fact, Olson (1982) attributes the rapid growth in both Asian and European countries affected by WWII to the breaking up of entrenched interests without giving any credit to industrial policy. To the extent that the broad, liberal planning approach used in West Germany, it is that by itself could have caused the East Asian growth. There are some evidence to support this other countries such as West Germany that benefited from the breakup of interest groups achieved high rates of growth without the same level of industrial planning. As East Asia.

15. The fact that the knowledge problem cannot overcome even leads to the interest group problems. If decision-making is not based on economic calculation, they must be based on something. Political and bureaucratic incentives are readily possible and in the interests of the decision-makers. Boettke (2001) states the problem by saying, "Since the economic knowledge necessary to plan the economy rationally will not be available to planners, these decision-makers will be forced to rely on the forms of information that are readily available, which in this context means promoting the expansion of capital goods and manufacturing power" (p. 52).

16. When controlling on the Mercedes-Benz, Adam Smith could have just as easily been speaking of state development planning when he wrote, "the interest of the consumer is almost constantly sacrificed to that of the producer, and it seems to consider production, and not consumption, as the ultimate end and object of all industry" (1776:715).

17. In a review of his 1802 book, Johnson (1999) comments one reviewer was concerned that "MITI's policies have strengthened the abstract entity called Japan but have not done much to enrich the lives of Japanese consumers and city dwellers. The Japanese people's standards of living have not changed anywhere nearly as much as the change in the economy for the gross national product" (1999:56). Johnson must agree with the observation since he offers no evidence or argument to refute the comment.

18. Similarly, in South Korea Choi (1994) notes that "South Koreas have been forced to pay exorbitant prices for whole goods that are protected consumer goods markets dominated by government-sanctioned monopolies and oligopolies" (1994:5).

19. Nisht (1962) finds evidence of this when examining growth rates in the Soviet Union. He found that the planning in the USSR systematically favored industrialization over consumption and leisure, thus exacting a heavy cost in both resources expended and human suffering (p. 292).

20. Even Stiglitz (2001:158) at least leaves room that the East Asian countries might have grown faster without the planning that occurred, though he does not think it is very probable.

21. Hong Kong has also ranked the most free country in the world by the Heritage Foundation and Wall Street Journal (2002). Indeed, the government is "free" because it has "no" in "free" since the index was created in 1995. It also says that "the bureaucracy must be "staffed by the best managerial talent available in the system." Evans (1995:12), writing on the internal organization of development states, says, "highly selective meritocratic recruitment" is used.

22. In measures that focus on consumer welfare, such as GDP per capita adjusted by purchasing power parity. Hong Kong is equal or superior to other East Asian countries (See Figure 1).

23. In this case, the subsidies caused Japan to possibly grow faster if there were more decentralized factors taking place. His theory has been described as his "00" theory, and later as his "Eastern Europe" theory. For a general overview of the failure of development planning around the globe see Boettke (1994).

24. Yet both these problems would have also resulted in higher freedom scores.


