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# POLICYINSIGHTS

INSTITUTE OF POLICY STUDIES OF SRI LANKA

## THE ASIAN DEVELOPMENTAL STATE – ‘GETTING THE INTERVENTIONS RIGHT’

### SRI LANKA STATE OF THE ECONOMY 2014

Rising Asia:  
Opportunities and  
Challenges for Sri Lanka



Throughout the major part of contemporary economic history, two dominant development paradigms prevailed. One took the view that markets would lead to efficient outcomes, whereas the other looked to governments to ensure resources were deployed in a way that promoted growth.

The latter half of the 20<sup>th</sup> century, however, witnessed the strong emergence of a number of East Asian countries which followed neither of these two extremes. The policy orientation of these economies was mixed in nature, where the state played a central role in facilitating structural adjustment. The models of economic policy and practice adopted by many of these successful East and Southeast Asian economies such as Japan, particularly at the height of their rapid industrialization and growth, has become known widely in the summary expression of ‘developmental state’.

#### The East Asian Miracle and the Role of State

Over the years, the remarkable success of the East Asian economies has stimulated a whole array of interpretations on the role of state. One interpretation – termed the Washington Consensus interpretation, attributes that the major part of East Asia’s success lies on the role played by the respective governments of getting the economic fundamentals right. Another version explains that the region’s success is beyond getting the fundamentals right, and attributes it to proactive governments, which leveraged industrial policy to facilitate structural adjustment and industrial upgrading in their respective economies.

Nevertheless, each of the successful East Asian economies is unique both in terms of their characteristics and respective pathways to structural change. Each economy differs in its geography, culture and history. Therefore, there exists no unique East Asian model per se, but what they share in common is the proactive nature in which the respective governments pursued economic policy in catalyzing their development. At the very heart of the developmental state was also, proactive ‘industrial policy’.

#### Government Intervention in Economic Policy

In addition to getting the economic fundamentals right, the governments of East Asia also took on a broader role in facilitating economic development by enacting policy interventions that assist enterprise growth

Efficient allocation of resources, driving competition and economies of scale, facilitating technology transfer are necessities in supporting the growth and competitiveness of the economy. Further, through resource mobilization within the public sector and effective bureaucracy, governments also played a direct role in coordinating investments. Apart from that,

**“The ideological debates should [by now] be over; there should be agreement that while markets are at the centre of the economy, governments must play an important role. The issue is one of balance, and where that balance is, may depend on the country, the capacity of its government [and] the institutional development of its markets.”**

*-Joseph Stiglitz*

infrastructure also played a key role in supporting a government's development policy. In the case of East Asia, infrastructure development was often closely linked to their industrial policies. As these policies had distinct priorities, infrastructure development projects could also be prioritized to suit the needs of the time.

At the onset of their development process, the East Asian countries focused on improving higher levels of education and ensuring that the education system was addressing labour market demands. Much like the infrastructure development strategies, developing human capital was also closely linked to the growth policies pursued at the time. As a result, education planning has played a crucial role in improving the human capital stock in East Asia. The education policies in many of the East Asian countries were integrated into the growth strategy of the country at the time and, therefore, the education system was geared to meet the labour market demands and minimize the potential occurrence of a skills mismatch.

### **Lessons for Sri Lanka from the 'Asian Developmental State'**

As for Sri Lanka, to gear towards a long-term, sustained economic growth path, it is important to understand and learn from the effective industrial policies used by the East Asian countries. In Sri Lanka, the majority of the country's workforce is still absorbed in low productive sectors such as agriculture and low/semi-skilled labour absorbing industrial sectors. Over the last decade or so, the government having recognized the need to move ahead and industrialize beyond the standard labor-intensive

manufacturing sectors, has taken a proactive stance. The government can also effectively drive development by pursuing policies aimed at efficient resource allocation, by encouraging competition among firms and by encouraging sectors which are weak and uncompetitive to make structural adjustments.

When it comes to infrastructure, the recent progress in the development of infrastructure in Sri Lanka is commendable given its importance to support growth and development. However, effective prioritization of infrastructure investment is essential given that the investment needs are often large and that it takes a long time to realize the economic returns of such projects.

Further, despite impressive performance of Sri Lanka in access to education, challenges remain in terms of improving the quality of education, access to higher education levels and the relevance of education. Therefore, it is necessary for Sri Lanka to gear its education policy to complement its long-term growth strategy and aspirations of its workforce.

Although the developmental states in East Asia have taken on a broader role than the standard neo-classical interpretation of government, markets were at the core of the developmental model. Rather than replacing the market, the developmental state nurtured and guided the private sector to become globally competitive. In the case of Sri Lanka's current development approach, it is important that the government enhances private sector participation instead of depending on a largely state-driven strategy.

(This Policy Insight is based on the comprehensive chapter on 'The Asian Developmental State – Getting the Interventions Right' in the 'Sri Lanka: State of the Economy 2014' report – the flagship publication of the Institute of Policy Studies of Sri Lanka. The complete 'State of the Economy 2014' report can be purchased from the publications section of the IPS, located at 100/20, Independence Avenue, Colombo 7. For more information, contact the Publications Unit on 0112143100.)



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