

institutions. While I think this book presents an excellent survey of selected theoretical literature viewed purely from a theoretical perspective, I found that many of the theories reviewed have weak empirical bases. After all, theory provides hypotheses; without empirical tests, statistical as well as casual, its validity cannot be judged. I doubt, therefore, that this book will be truly useful to those interested in this controversial subject.

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Michael E. Porter, *The Competitive Advantage of Nations* (Free Press, New York, 1990) pp. xx+855.

Michael Porter's *Competitive Advantage of Nations*, though it is written from the perspective of the business school rather than the economics department, and is primarily focussed on understanding the distribution of leading positions in industries held by the advanced economies, is potentially an extraordinarily important book for the development field. It is the first serious attempt to develop a really original grand theory of national economic development processes since the early years of Postwar development economics, and represents one of the most original ways of thinking about development policy in years.

In chapters 3 and 4 Porter presents his 'determinants' and 'dynamics' of national competitive advantage, which he informally models as centering around four elements, which he calls the 'diamond of competitive advantage': (1) factor conditions, (2) demand conditions, (3) related and supporting industries and (4) firm strategy, structure and rivalry. These four elements influence each other, while being influenced by two largely exogenous elements, 'chance' historical events and cultural legacies, and government policy.

Porter's key departure from standard neoclassical trade theory is to posit a *qualitative* difference between 'basic factors' and 'advanced factors'. For the former, which include physical resources and unskilled or semiskilled labor, standard theory applies. But for the latter, which are more specialized, and include highly trained personnel with specific human capital, and 'knowledge resources', such as government and private research institutes, leading universities and industry associations, Porter argues that standard theory can

be misleading and needs to be augmented with a more Schumpeterian, nonequilibrium analysis.

Porter argues that 'selective disadvantages' in lower-level factors can be a hidden advantage because it 'forces innovation' in advanced factors. A similar argument has been made by students of Taiwan and South Korea, but has not been taken very seriously, perhaps because the point has been expressed intuitively and has not been grounded in any theory of microeconomic behavior. Porter now offers such a grounding, although not a strictly neoclassical one, certainly one based on a testable and widely accepted (in business departments) model of corporate decision-making and organizational behavior.

Porter's central propositions about demand conditions is that firms are better off when they face 'sophisticated, demanding buyers' and home demand composition is 'anticipatory of buyer needs' abroad. He argues that the size of the home market is only of secondary importance; and that large size is more valuable in the presence of large research and development costs and large uncertainty, as well as economies of scale in production. Also important in determining national advantage is the rate of growth of home demand, and the 'early saturation' of home demand, forcing firms to export to expand or survive. The larger the number of independent buyers, Porter argues, the better for the industry as a whole. 'Too much "captive" foreign business can undermine competitive advantage by reducing the pressure to improve and innovative' Porter argues (p. 99), strongly contrary to at least part of the dependency model (it may do little good for the 'captive' buyers, either). It is not as close to a tautology as it sounds to say that captive buyers (lack of competition) undermines competitiveness, because the model includes benefits for undertaking the world-leading role in innovation when firms can be confident of market power in their outlets for new products.

In the case of developing countries, 'demand conditions' are generally not 'advanced', and Porter argues (Chapter 10) that sophisticated demand conditions do not become an advantage until the third, innovation-driven stage of development. Demand conditions also offer no advantage for the competitiveness of the nation unless there is also demand abroad. But a possibility for consideration is that the potential home market demand for 'appropriate', modern but more labor-intensive technology, could be the basis for the development of an industry oriented toward exports to other developing countries. One limitation may be the need to earn hard currency from exports due, for example, to debt overhang. Development policy could potentially play a role on both counts.

Porter argues that success in one industry can spur success in related industries (one example: VCRs and videotape in Korea). Economies of scope, particularly the stimulus of new methods in industries presumably with related processes, and the interaction of buyer needs and intermediate

supplier capabilities, are stressed. Argued advantages to having a competitive domestic supply industry for the development and maintenance of a cluster of firms include lowered transaction costs, free and open information flow due to proximity and cultural similarity, spawning of new domestic entry, and international marketing alliances.

Regarding firm structure, strategy and rivalry, Marshallian industrial districts, which Porter calls 'clusters', play a key role in the book. Argued advantages include diffusion of ideas, their relationship to existing country demand (cultural) characteristics, conduciveness to spinoff startups, inherent support for 'sustained commitment' in a segment, the 'visible pressures' to keep up with changes in the industry, and finally the extra motivation supplied from the personal rivalries which commonly occur from proximity (several examples from Japan are offered). Importantly, domestic rivalry is argued to be much more effective than rivalry with foreign firms. In part for these reasons, the national champion strategy is argued to be inherently ineffective. Interestingly, Porter also suggests that 'too much mobility' of factors can be a national disadvantage in this environment. All of this may be important for the understanding of causes of failures of public enterprise and especially 'antiduplication planning' in LDCs: Even at an early stage of development with a much larger role for government the loss of the environment of rivalry is key.

Import substitution is lambasted as a long-term strategy, but embraced as a temporary measure for developing future export industries (as in Korea). An outward orientation is strongly embraced over inward-looking policies, but generally not for the reasons associated with the free trade school nor with its association with policy neutrality. Nor are (static) economies of scale seen as particularly important when traded off against the dynamic economic benefits of intense domestic competition. Any waste thus involved is seen as merely a static loss that can be overwhelmed by, in effect, x-efficiency gains, dynamic allocative gains, and Schumpeterian progress: 'Static efficiency at a point in time is rapidly overcome by a faster rate of progress' (p. 20). Porter's model is not one of equilibrium but of economic evolution. But this explains only in part his stress on 'fierce' competition and 'even personal rivalry'; Porter is equally stressing its salutary effect on the content of economic policy (pp. 662-669). Porter argues that rivalry in an industry channels government policy activities into effective directions, such as supporting advanced factor conditions. In contrast, when rivalry is lacking, firms lobby for individual protection and other assistance (what economists call rent seeking), which ultimately undermines dynamic efficiency and international competitiveness. Thus the analysis offers only limited comfort to any of the traditional general positions on development policy.

Government's role, Porter argues, is not as a fifth independent determinant, but in influencing the competitiveness-enhancing character of the first

four determinants, in particular through education and training, capital market regulation, and through its status as a major buyer. Government can increase the odds of attaining competitiveness in industries through these means, Porter argues, but has no power to create advantage itself.

Porter devotes a short section (pp. 675–680) specifically to ‘government policy in developing nations’. Among his more interesting conclusions: ‘The central task facing developing countries is to escape from the straightjacket of factor-driven national advantage ... where natural resources, cheap labor, locational factors, and other basic factor advantages provide a fragile and often fleeting ability to export ... vulnerable to exchange rate and factor cost swings. Many of these industries are also not growing, as the resource intensity of advanced economies falls and demand becomes more sophisticated... Creation of advanced factors is perhaps the first priority... Yet sophisticated demand and supporting industries are necessary for continued development...’ Although some of this is reminiscent of traditional, structuralist arguments, when combined with the rest of his model, very different conclusions are drawn, stressing the encouragement of very active rivalry among private sector firms. Relatedly, on the advantages of market over planned economies, Porter stresses the dynamics of rivalry among firms over static allocational benefits.

Porter also stresses that ‘foreign multinationals should be only *one component* of a developing nation’s economic strategy, and an evolving component... Government should encourage the formation and upgrading of indigenous companies in related and supporting industries to those in which multinationals operate, not solely with an eye toward import substitution but ultimately as international competitors. This will not take place, however, without the parallel development of human resource skills, a scientific base, and infrastructure in those fields to support higher-order competitive advantages... Multinationals should also be cultivated whose rationale for locating in a nation goes beyond basic factor considerations... The ideal is to make the nation almost a “home base”.’ Porter also argues that governments and firms must work toward developing independent national brand names rather than working as an ‘original equipment manufacturer’.

Porter argues (pp. 681–682) that ‘Government has an important role in influencing the “diamond” (but)... it only succeed when working in tandem with the determinants... Government’s proper role is as a *pusher and challenger* (original emphasis). There is a vital role for pressure and even adversity in the process of creating national competitive advantage. These are drives that government, by providing too much [direct] assistance, undermines. Government’s role should be to transmit and amplify the forces of the “diamond” as well as help upgrade the determinants themselves. Sound government policy seeks to provide the tools necessary to compete, through active efforts to bolster factor creation, while ensuring a certain discomfort

and strong competitive pressure... At the broadest level, one of government's most essential roles is signaling. It can influence how firms compete by identifying and highlighting the important priorities and challenges they face... [G]overnment must recognize those areas in which it has a legitimate influence in creating the conditions for economic prosperity. These areas are different, and broader in many ways, than those which preoccupy much contemporary policy debate...'

Porter's 'four stages of competitive national development' examined in detail in Chapter 10 are (1) the (basic) factor-driven stage, in which 'basic factors' are the 'essential source of advantage', (2) the investment-driven stage, in which the beginnings of more advanced factor creation can be seen, size and growth of domestic demand becomes an advantage, domestic rivalry becomes very intense, and motivation is high (which brings to mind McClelland's 'N-Achievement' hypothesis), (3) the innovation-driven stage, in which firms develop a global strategy, domestic demand sophistication becomes an advantage, related and supporting industries develop, advanced and specialized factors develop, selective factor disadvantages can become an advantage; and finally, though not inevitably, (4) relative decline into the wealth-driven stage. Refreshingly, Porter stresses that there is nothing inevitable about passing through the stages; cultural influences are taken seriously. In its concentration on behavior of the firm, the model loses some generality but gains analytical power.

Porter offers some interesting observations on Korea, the only developing country he examines in detail, and one widely regarded as a candidate for developed country status. 'Korea began the 1950s in the factor-driven stage... In contrast to ... all other Asian NICs including Taiwan, however, Korea fully achieved the investment-driven stage by the 1980s. The Korean government and Korean firms adopted the more risky course of limiting the role of foreign multinationals, seeking to establish indigenous industry, and borrowing heavily from abroad to finance aggressive investment. The result is the potential for the sustained upgrading of industry and far greater long-term prosperity... The Korean government has played a heavy role thus far, directing scarce capital, limiting foreign investment, assisting in foreign technology licensing and protecting the home market. Like Singapore, Korea has invested aggressively to upgrade human resources and infrastructure. Unlike Singapore, Korean development is based heavily on Korean companies though multinationals have some role... Korean firms and the Korean government have also begun investing in research... What most sets Korea apart, in addition to fierce domestic rivalry, is its ability both to fully assimilate and to improve upon foreign technology... However, Korea still lacks the demand conditions and related and supporting industries necessary for achieving innovation-based competitive advantage. It competes largely in end products, though these are of growing sophistication. The Korean

market position is improving in industrial and supporting industries, a sign of upgrading. Yet product designs are still largely from abroad, and products are made from foreign components with foreign machinery... The challenge facing Korean industry is how to continue upgrading to reach the innovation-driven stage'.

In sum, the development advantages of Porter's model include: it links LDCs with MDCs in a continuum; it focuses on the achievement of developed country status and stresses a deep understanding of what this really means and what its real requirements are; and it focuses on the firm and internal firm requirements for long-term success, which has been lacking in development theory. The alternative of simply applying an unalloyed paradigm of neoclassical analysis plus the assumption that government failure is always greater than market failure seems weak by comparison. The Porter approach may ultimately offer a partial blueprint for really reaching advanced country status, an alternative to either more conventional development planning, or to rapid, all-out liberalization as a 'second-best' strategy in the face of 'government failure'.

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Azizur Rahman Khan and Mahabub Hossain, *The Strategy of Development in Bangladesh* (Macmillan, in association with the OECD Development Centre, London, 1989), pp. xvii + 198.

This book provides an overview of the performance of the Bangladesh economy since the country's independence from Pakistan in 1971. It is the second in a series of country studies under the OECD Development Centre's research program on 'Economic Choices before the Developing Countries', which seeks to assess the strengths and weaknesses of widely-advocated development policies in the light of actual experiences.

From independence until 1986/87, per capita GDP in Bangladesh grew at 1.64 per cent per annum, well above the pre-independence (1949/50 to 1969/70) growth rate of 0.66 per cent. As the authors note, however, the comparison is somewhat misleading since GDP declined sharply during and immediately after the independence war, so that the point of departure for the post-independence trend was an abnormally low level of income. Per capita GDP did not reach its pre-independence peak until 1980/81, and if the pre-independence trend had continued without the 1971 break, per capita GDP even in 1986/87 would have been higher than it actually was. If the people of Bangladesh hoped that independence, after nearly two centuries of