The developmental state

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The two forms of economic coordination of capitalism that we discussed in the last chapter – developmentalist and liberal – correspond to two ideologies, each ideological camp asserting the superiority of its own form of economic coordination of capitalism over the other. Neoliberals claim that liberal capitalism is a superior form of economic coordination of capitalism because markets are an impersonal form of optimal resource allocation that ensures increased productivity by encouraging hard work and punishing laziness. This, however, is a claim that has no basis in economic reality. Developmentalists argue that the developmentalist form is capitalism's superior form of economic coordination because it sees the state and the market as complementary institutions and relies on a policy to determine which industries should be most regulated by one or the other coordinating institution. While the market is the state-regulated institution that coordinates the competitive sector of the economy, the state is the fundamental institution that regulates all social life and, on the economic level, mainly coordinates the non-competitive sector.

Before capitalism, markets were local fairs and played a marginal role in economic coordination. Under capitalism, large domestic markets and an international market were built. Capitalism is often called the "market society": a reductionist term. As Marx rightly observed, capitalism is the form of social organization where money and the market are the main economic institutions. The formation of nation-states ensured the formation of national domestic markets. Britain was the first nation to form its state, then form its nation-state and carry out its industrial revolution. It was also the first national society to have its economy coordinated by a national market. This was followed by France, Belgium and the Netherlands. Countries like Germany, Italy, and the U.S. took longer to form or unify their nation-states, and their industrial revolutions came later. All industrial revolutions have taken place within the framework of developmentalism.

The developmental state defined

Considering the four forms of Capitalist Revolution that we discussed in Chapter 2, and the two forms of economic coordination discussed in Chapter 3, we can say that, in modern societies, the degree of state intervention in the economy was high during the industrial revolutions, fell during the liberal-industrial phase, increased again during the capitalist-managerial phase, fell again in the neoliberal-rentier phase, and now, with the collapse of neoliberalism, it is starting to rise again.

A national society will be liberal if the state limits itself to guaranteeing property rights and contracts, keeps its fiscal accounts balanced and, within the framework of neoliberalism, is involved in reforms aimed at reducing its own size and eliminating its policy of intervention in the economy. If its policymakers adopt the liberal policies and reforms that rich countries have been engaged since the 1980s. A society will be developmental if it sees economic development as the result of a political aspiration or project whose main instrument is the State. A society would be statist, as Soviet society was, if the state controlled the entire economy.

The definition proposed here is not prescriptive. It is a generalization of the behaviour of the developmental states that exist today in East Asia, from Japan to China and Vietnam. Assuming that the behaviour of each of the East Asian countries is similar, South Korea summarizes the developmentalism adopted and economic success achieved. Developmental policy in the boom years (1970s to 1990s) was characterized by high import tariffs in the range of 30% to 40% in the 1970s and 20% to 30% in the 1980s, many non-tariff barriers to the import of manufactured goods, export subsidies subject to the condition of good performance, low external debt-to-GDP ratio, small fiscal deficits, small and tightly managed current account deficits, heavily regulated financial markets; low, often negative, interest rates; competitive exchange rates; strict control of capital inflows and outflows, and annual inflation of 17.4% in the 1960s and 19.8% in the 1970s.[i]

Considering the two historical forms of economic coordination of capitalism, the developmentalist form is the *default form*, since all capitalist societies were born developmental. It was within the framework of developmentalism – not economic liberalism – that they formed the nation-state and carried out their industrial revolution. The developmental state is at the centre of the history of capitalism because it is also the history of the nation-state. But economic liberalism is also at the heart of capitalism because it has been an ever-present institution, and always in conflict with the developmentalist alternative.

Chalmers Johnson offered a detailed definition of the developmental state.[ii] It is the state that has economic development as its main objective and intervenes in the economy not only through regulation, but also directly. It has a small and highly qualified public bureaucracy to which real powers are attributed, leaving the Legislative and the Judiciary in the background. It controls your overseas business and financial accounts and therefore the exchange rate. It protects your domestic manufacturing industry from foreign products and makes it easier to import machinery. It separates foreign technology, in which the bourgeoisie has a strong interest, from foreign capital, in which interest is limited. It creates state-owned financial institutions and adopts credit and tax incentives, but always on a temporary basis and subject to constant evaluation. It adopts a consolidated public investment budget. It offers strong government support for science and technology, and ultimately avoids detailed laws, leaving room for companies to take the initiative, with discretionary guidance from the public bureaucracy.

Peter Evans drew attention to two characteristics of the 20th-century developmental state: its bureaucratic capacity – the capacity to implement the law and public policies – and its social insertion: the way in which the public bureaucracy is *embedded* into society and the business community.[iii] Johnson and Evans credit the public bureaucracy with a strategic role, although industrial entrepreneurs also have a decisive role to play in the developmental state.

These are excellent definitions of the developmental state, but they are too demanding. One usual way is to identify the developmental state as one that adopts active industrial policy, but this is a very limited definition. For New Developmentalism, a state is developmental when (1) in addition to practicing industrial policy, (2) it adopts some macroeconomic policies that favour development, such as an interest rate that varies around the international interest rate plus country risk, and a relatively managed exchange rate to be competitive, so that companies that use the best technology are competitive; (3) when it is supported by a developmentalist class coalition formed by businessmen, workers, public bureaucrats and, in the case of developing countries, also formed by sectors of the former ruling class that hold political power and their interests coincide rather than conflict with developmentalist policies.

Class Coalitions

The relevant class coalitions in the economic history of capitalism are the developmentalist coalitions and the liberal class coalitions. These correspond to our two forms of economic co-ordination of capitalism. The paradigmatic developmentalist coalitions today comprise businessmen, the public bureaucracy and the working class, implying a broad social commitment. Paradigmatic liberal coalitions comprise the small businessmen, the rentier capitalists, the financiers, the non-managerial middle class, and the wage classes.[iv] Note that by waged or popular classes I mean the working class, low-level employees, and lower-middle managers. In contemporary capitalism, we cannot understand the workers as being the only component of the popular classes. The number of employees is growing slowly, while the number of employees is constantly increasing.

Class struggle is inherent to capitalism, but struggles are not "resolutive" insofar as a classless society remains a distant utopia. It is impossible to understand modern societies if we do not consider other social drivers and their initiatives. Developmental class coalitions, for example, have played a key role in moments of significant change in the history of capitalism. They presided over the formation of nation-states and industrial revolutions in all countries and were present in most periods of rapid economic growth, for example during the period just after World War II.

Developmentalist class coalitions lead to a developmental state in which, although social conflicts remain alive, agreements or compromises can resolve them. An important question is whether agrarian elites participate in coalitions of developmentalist classes. As Marcus Ianoni noted, "in South Korea and Taiwan, rural society converged with industrial progress, not seeking an independent political settlement."[v] The same applies to the German agrarian elites that Bismarck managed to bring into his political coalition. The case of Latin America is different: the agrarian elites who exported commodities opposed industrialization and developmentalist policies such as import tariffs on manufactured goods. They and the imperial centre saw these import taxes as protectionist and inefficient, even though they were a condition for the industrialization of all countries from England onwards.

Chalmers Johnson and Peter Evans were among the leading analysts who attributed a strategic role to the public bureaucracy in the developmental state. This is true, but unlike Asian industrialists, Latin American industrialists are a contradictory or ambiguous class; That’s why I use an oxymoron and call them "national-dependent." However, in the periods of industrialization and recovery, this class of industrial entrepreneurs played a decisive role, insofar as it commanded the process of capital accumulation and innovation: the two main sources of economic growth.

Developmentalist class coalitions are always changing. The post-war developmentalist class coalition in the advanced countries – the managerial or Fordist coalition – was a broad coalition that embraced industrial entrepreneurs, managers, the public bureaucracy, and the working class. The ruling class coalition since the Neoliberal Turn of 1980 – the neoliberal coalition – is a close agreement between rentiers, financiers and the top executives of business corporations. Class coalitions are loose and fluid. When the capitalist class feels threatened by left-wing political parties, it tends to mobilize, and the developmentalist class coalition fails. Under normal conditions, the ruling class is divided: rentiers and financiers remain loyal to economic liberalism and therefore dependent or colonial on the core countries, while industrial entrepreneurs are nationalist or developmental. It is often difficult to distinguish between entrepreneurial capitalists and rentier capitalists, but as we will see in this book, such a distinction is relevant in the study of capitalist societies.

The role of the state

Developmentalism is not a form of state capitalism, but a form of capitalism in which state and market complement each other. By being permanently engaged in the reform of institutions, nations build their state and their markets. Actions related to this construction can be seen as spontaneous, but they are not; Societies have relatively clear goals in mind when they engage in institutional reforms. Institutions can be progressive or conservative, pro-growth or anti-growth, but no institution exists outside the process of political construction.

New Developmentalism adopts a simple criterion to define the economic roles of the state and the market. It distinguishes the competitive sector from the non-competitive sector in each economy and maintains that, whenever there is effective competition, the market is the best coordinating institution. It allocates resources automatically and more efficiently than the state and is open to creativity and innovations. Thus, a company can be part of an oligopolistic sector, but if that sector is not organized as a cartel, I understand that it is competitive. Most companies are in the competitive industry. The infrastructure sectors, basic inputs, and the banks "too big to fail" banks are typically non-competitive industries. An industry is only competitive if its companies can go bankrupt.

In the non-competitive sector, the state must coordinate, that is, it must plan investments. Ideally, the companies should be state-owned. The privatization of monopolies or quasi-monopolies does not increase the efficiency of firms, because there is no market to ensure that only the efficient ones survive. What happens to companies after privatization is that they raise prices and reduce the quality of the services and goods they offer.

State action is also necessary in relation to the five macroeconomic prices (the rate of profit, the rate of interest, the wage rate, the inflation rate, and the exchange rate) because the market is not able to coordinate them satisfactorily. The prominence of central banks in modern societies represents the recognition of the market's inability to keep interest rates and inflation rates correct.

The state is an immense machine for the distribution of income, whether in favour of the rich or the poor. Subsidies in the form of tax cuts for certain privileged groups, deregulation of the financial sector, privatization of monopoly state-owned enterprises are all forms of violence against republican rights. Increases in spending on public education, health care, and social assistance, including cash transfer programs for the very poor, are legitimate actions, consistent with the common good or the public interest. Thomas Piketty, in his extraordinary theoretical and empirical book, Capital in the *Twenty-First Century*, demonstrated the tendency for inequality to increase in the 20th century at times when the coordination of capitalism was left to the market.[vi] In times of economic liberalism, the rich are always the beneficiaries.

The rate of profit has been kept at a relatively stable level since the 1870s, falling only in one crisis. Long-term data on the rate of profit and the product-capital ratio are scarce and outdated. Duménil and Lévy, considering the period 1869-1989 in the USA, show that this relative stability had two major falls: depressions in the 1890s and the 1930s. In contrast, the productivity of capital from 1860 to 1890 is stable until 1929 and then falls and recovers to the level of 1860 in the 1930s. It fell again until 1980 and, since the neoliberal years, has shown some recovery.[vii] Michael Robert, considering the period 1950-2004, confirms the recovery of the rate of profit from 1980, and again remained relatively stable from 1990 onwards.[viii] Since that date, it is likely that profit rates have not fallen because private companies have been involved in an intense process of mergers and acquisitions. This allowed them to increase their monopoly power and increase their profit margins. Recent research by John Van Reenen confirmed the growing monopoly power of corporations.[ix]

Finally, the protection of the environment and the control of climate change are today a condition for the survival of humanity – they are problems for which markets have no answer. On this subject, I am always reminded of the lecture given by Georgescu-Roegen at the University of São Paulo after publishing his pioneering 1971 book*, The Law of Entropy and the Economic Process*. Two neoclassical economists disagreed with him, saying that future interest rates would solve the problem.[x] This led him to remark, "you're thinking parochially; I'm discussing the economy that our children and grandchildren are going to live in." Investing in climate change also has significant economic benefits. In 2016, responding to a question posed by the *New Left Review* about the prospect of secular stagnation proposed in Robert Gordon's book*, The Rise and Fall of American Growth*, Michel Aglietta, using a Schumpeterian argument, dismissed this prediction because a new wave of investment was on the horizon – investments to deal with climate change – and a country endowed with a strong developmental state – China – was likely to lead this new wave.[xi]

Once a country completes its industrial and capitalist revolutions, it tends to remain developmental, although the degree of state intervention in the economy falls. The country today has a large stock of capital, an adequate supply of entrepreneurs, managers, technicians and workers, and well-structured markets fully capable of coordinating the competitive sector of the economy. But state intervention is still necessary for the coordination of the non-competitive sector; for the adoption of industrial policies in both sectors; for the control of the two macroeconomic accounts (fiscal and current), and for the management of the five macroeconomic prices. Under the pressure of changing economic elites, the degree of state intervention may fall more than it should, and the political regime becomes liberal. This was, for example, what happened in the rich countries around 1980, when, under the pressure of rentier capitalists and financiers, we had the Neoliberal Turn. We will discuss this change in Part III of this book.

The distinction between developmental and liberal states is irrelevant when we have what Peter Evans called a "predatory state" – when the state "does not have the capacity to prevent individual incumbents from pursuing their own goals. Personal bonds are the only source of cohesion, and individual maximization takes precedence over the pursuit of collective goals."[xii] Predatory states exist in pre-industrial countries that are far from carrying out their capitalist revolution. Its rulers claim to be developmentalists or liberals, as expediency dictates, but that means little or nothing.

[i] This summary is based on Ha-Joon Chang (2002b) and a lecture at the Sixth Latin American Advanced Programme on Rethinking Macro and Development Economics (Laporde), São Paulo, January 11, 2016.

[ii] Johnson (1982; 1999).

[iii] Evans (1992) "The State as Problem and Solution: Predation, Embodied Autonomy and Structural Change".

[iv] It is important to distinguish the concept of "class coalitions", which is a sociological rather than a political science concept that involves agreements between social classes, from "political coalitions", which are coalitions between political parties to achieve a majority and govern. Both concepts are related, but in this book, I mainly use class coalitions, which are more informal and long-term than political coalitions.

[v] Ianoni (2014, p. 99).

[vi] Piketty (2013: sections 'Back to Marx's tendency to fall the rate of profit' and 'Beyond the "two Cambridges"': 360-369).

[vii] Duménil e Lévy (1993: 254).

[viii] Roberts (2009:42).

[ix] Reenen (2018).

[x] Georgescu-Roegen (1971).

[xi] Gordon (2016); Aglietta (2016).

[xii] Evans (1992: 12).