Developmental state and Africa's present level of growth

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Is Africa currently in the developmental stage? Is it on its way to economic success and ultimately development and liberal democracy?

Does the role of the state in the development of East Asian countries offer good examples for Africa?

Is the state in developed countries supporting or subsiding key private companies in their economies?

Let us start with the two views of Thomas Hobbes of 1651 and Rothbard of 1973. Thomas Hobbes described life without government as 'nasty, brutish, and short' and went further to that the law and order provided by the government was a necessary component of civilized life. On the other hand, Rothbard (1973) argues that the private sector could effectively undertake all of the functions usually done by government.

The view that the state should play a leading role in the economic development of developing countries was central to development economics up and until late 1970s. The 'Big Push' theory of industrialization (which was put forward by Paul Rosenstein-Rodan 1943 and Tibor Scitovsky1954) gave a crucial role to the state - as a coordinator of complementary investment decisions in the developmental process. Alexander Gerschenkron (1966), constructed his theory of late development around the rising need for state involvement in industrial financing that is supposed to arise from the continuous increase in the minimum efficient scale of production owing to the nature of the modern technical progress. His central argument is that late industrialization requires heavy capital investments and that in order to obtain such capital, countries such as France, Germany, and Russia were prompted to generate new institutional mechanisms for generating savings.

Absence of such a nationalistic developmental state as found in the early development of capitalist Europe or Japan – Meiji Japan was identified as the major cause for the underdevelopment of several poor countries[1]. It should be note that the idea of centrality of

[1] See Paul Baran (1957), "The Political Economy of Growth", monthly Review Press, New York

the state in economic development was not invented by the early development economics of the 1950s and or the 1960s. There had been a similar view of the role of the state that had been put forward by the German historical school represented by Friedrich List. Friedrich List had been influenced by the American economists of the 18th century including Alexander Hamilton. Some others trace these ideas on the role of the state and economic development far back to the 16th century mainly to England and Venice (now in Italy)[2].

Richard A. Musgrave widely regarded as the founder of modern public finance and an adviser on fiscal policy and taxation to governments from Washington to Bogota to Tokyo[3] sees the state playing an important role. HE considered the role of the state in three parts: stabilization; distribution; and allocation. He also considers public goods which have to be provided by the state partly because of the existence of negative externalities and market failure. According to Musgrave[4], the government has three economic functions, which include stabilization, distribution and allocation. The first two functions are usually beyond the control of the state or local government and are managed at the national level of government. The third function, allocation, is the basic concern of the local government. The allocation function can be defined in simple words as the provision of socially desirable public goods.

Gunner Myrdal writing in *Asian Drama: An Inquiry into the Poverty of Nations (1968)*[5]argued that the major reason for the economic stagnation of many developing countries lay in the absence of a 'hard state' that can surmount conservative interests in favour of social reforms and economic transformation. The Asian countries of Singapore, Taiwan, Malaysia, and South Korea seem to have heard his message. They undertook to and developed their countries originally with benevolent leaders, with less liberal democracy. The state originally played a key role including establishing and owning big companies. China has followed suit. It is realizing high levels of growth under their so-called social market economic system.

In the late 1970s, there was a U-turn on the developmental state across all social sciences, and particularly the economists who began advocating individualism, liberal markets ('opening up markets'), and a small state or contraction of the state. These were neoliberal ideas. In academia the Keynesian justifications for state intervention were replaced by both the monetarist theory[6] and the rational expectations 'revolution, and meanwhile in the political arena Margaret Thatcher (UK) and Ronald Reagan (US) led the 'barrel' to reduce public spending. Thatcher heralded the sale and divestiture of state owned enterprises.

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[2] Chang Ha-Joon (1999), "*The Economic Theory of the Developmental State*", in Woo-Cummings, M., (ed.): The Developmental State, Cornell University Press, Ithaca and London.
[3]Source: http://news.ucsc.edu/2007/01/1026.html (accessed on 12/10/13)
[4]http://www.essie.ufl.edu/~fnaja/chapter4.html (accessed on 12/10/13)
[5] Gunner Myrdal (1968), Asian Drama: An Inquiry into the Poverty of Nations, New York: Twenty-First Century Fund.
[6]Heavily supported by Milton Friedman and the so called *Chicago School of Economists*

Liberalization and depoliticization

With regard to policy proposals, since the late 1970s and mainly in the 1990s, the current focus of economic growth and development has focused on two closely interrelated concepts total liberalization an economic aspect, and depoliticization (with its implied 'no state regulation') as a political aspect.

The role of the price mechanism dates back to Adam Smith's suggestion of the 'invisible hand'. The forces of demand and supply should determine quantity demanded and quantity supplies and quality. Quality is related to the price and affordability. Class comes to raise the price of branded goods and most goods of ostentation. If conditions in the market were perfect and buyers and sellers had perfect information about where to buy, the quality, and prices, there would be not major problem with the 'invisible hand'. However, in developing countries (and even in rich countries), information asymmetry indeed exists. This does not permit the efficiency of markets. Therefore, liberalization or opening of markets ("getting the prices right") may not provide a solution for the growth of developing countries in Africa.

Right prices in neoliberal economics means those prices that prevail in a totally unregulated domestic or international market. In the domestic market "getting the prices right" means deregulation of product and factor markets. It means no government regulation, at all, of the market. It means, among others, divestiture of state owned enterprises. With regard to international trade, "getting the prices right" means opening of trade and competing as a country and its businesses with the rest of the world. Opening up may have to consider the principle of *asymmetry* with regard to international trade.

The principle of asymmetry in trade matters a lot. *Asymmetry* in trade negotiations and relations refers to 'less than equal' realization that some countries are more developed than others. During trade negotiations, this fact should be considered. For example when negotiating the levels of liberalization, the EU should open up more of its economy than African countries. Tussie & Saguier (2011), while there may be degrees of asymmetry between forces, we apply the term to the circumstances in which there is a significant disparity between contending parties, no consideration of such disparity and no fair chance of matching up forces in the process. By using the concept of asymmetry we assume that there is more than a mere high level of interdependence in these relations. We are hence concerned with absolute rather than relative asymmetry. As a result of such asymmetry the trade agreements (FTAs) not only cover the reduction or elimination of tariffs and other non-tariff barriers on the trade of goods and services, but they also cover broader elements of interest to developed countries such as investment rules, intellectual property rights and so on (Tussie & Saguier (2011:2)[7].

Depoliticization: political determination of economic outcomes is viewed as mainly leading to either social waste (including rent-seeking and corruption) or minority interests of those non-democratic leaders over the majority interest. While the majority contributes taxes, labour, and produce children used in the military and police, they usually suffer poverty and ill-treatment by the small click of the elites who capture and use power for selfish ends. Because of this, there is a lot of literature under the disciplines of politics and economics and powerful forces that recommends depoliticization. They see the liberalized market as the way to disciplining such minority selfish interests. Markets should be self-regulating. While we agree the minority interests have taken over from the majority in African countries, we can't wholesale confirm that liberalization is the answer.

The World Bank (2005), "Economic Growth in the 1990s: Learning from a Decade of Reform" has found that liberalization is not a panacea for rapid and sustained growth in developing countries. Some countries that liberalized have achieved high levels of growth but some have not. There more factors to consider than just market liberalization. Undeveloped markets may not just growth and lead to development by immediately opening wholesale. We note in this book that there hardly any 'opened up' economies in the world. The EU and USA are in a marathon negotiating trade and investment agreements in all the corners of the world. Why this? They know that their and other countries markets are not open.

Nobel laureate in Economics and former Chief Economist The World Bank, Joseph Stiglitz has written that lack of regulation is the price of inequality in USA[8]. He argues that left on their own devices, markets are neither efficient nor stable and will tend to accumulate money in the hands of the few rather than engender competition. Stiglitz argues that a free and competitive market is highly beneficial to society at large, but that it needs government regulation and oversight to remain functional. Without constraint, dominant interests use their leverage to make gains at the expense of the majority. Concentration of power in private hands, Stiglitz believes, can be just as damaging to the functioning of markets as excessive regulation and political control[9].

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[7]Tussie, D., and Marcelo Saguier, M., (2011), "The Sweep of Asymmetric Trade Negotiations: Overview", Region, Regionness and Regionalism in Latin America: Towards a new synthesis; Serie Working Paper 130, Abril 2010 (To be published in S Bilal, P de Lombaerde and Tussie (eds) The Sweep of Asymmetric Trade Negotiations: Problems, Processes and Prospects. Ashgate 2011

[8] Joseph Stiglitz (2012): The Price of Inequality. W.W. Norton & Co., Inc.

[9]Thomas B. Edsall "Separate and Unequal: The Price of Inequality by Joseph E. Stiglitz" source:http://www.nytimes.com/2012/08/05/books/review/the-price-of-inequality-by-joseph-e-stiglitz.html?_r=0 (accessed on 12/8/13))

We are not suggesting import substitution massively supported by developing countries in Africa and probably with even donor funds. We are observing that during the process of growth, industrialization and later development and democracy, developed countries of Asia were not always free markets and liberal democracies. We have also shown that it the same stages that the rich and developed countries followed. We have given two example of how USA and UK to demonstrate how they developed both politically and economically.

The most important ingredient in growth and development is political leadership and institutions. Without these two there is no direction in the economy and the politics are messy. Such an economy cannot 'see its head up'. As they say 'the fish starts to rot from its head'.

A look at the East Asian Economies and rapid growth and development

The emergence of the power of Neo-liberalism and the tendency to view the role of the state in a narrow focus has ruled the world mainly since late 1970s. They assert that the government should mainly tax business and individuals – but play no role in the private sector. They forget that in most developing countries, there exists market failure all the time. Robert Wade (1990) writing in *Governing the Markets*[10]that Asian advanced countries such as Taiwan grew under a 'hard state' role. Wade shows that in Taiwan, public investment was equal to around a half of the national investment. Let us look at Singapore which has been viewed as one where its leaders seldom picked winners. There is a big role of the state in the mobilization of public savings. From a public savings perspective, however, Singapore's massive public savings of 18.5 percent of GDP suggests a powerful promotional stance, in which the state single-handedly created a pool of total savings larger than most nations can create through both public and private savings[11].

Look at **South Korea** which claimed that it was a free market economy when it grew rapidly. Let us look that the country before the Asian economic crisis of 199/8. Population growth rate were low around at 2.16 per annum between 1950 -73 at 1.25 per annum from 1973 to 1998[12]. Between 1950 and 1998, the absolute number of population increased from 20.8 million to 46.4 million. This is an increase of 25.6 million in 48 years. By 1950 it has a total GDP of US$16 million and it had reached US$56.4 million in 1998. This is an increase of US$ 40.4 in 48 years. By 1996, it was the 12th largest economy in the world and had become a member of the OECD (the first of the Asian tigers to be admitted). Specifically, its annual average growth rate of GNP was about 10 per cent between 1965 and 1980. Let us observe that if we exclude the OPEC members and the command economies (centrally planned economies), it had the fifth

[10]Wade, R., (1990): Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization. Princeton, N.J: Princeton University Press
[11] Krieckhaus, J., (2004): "In Praise of the State", Issues & Studies 40, no. 1:46-60.
[12] Maddison Angus, The World Economy: A Millennial Perspective, OECD (2001: 218)

highest growth rate of real GNP in the 1960s and in the 1970s, and for some part of the 1980s[13]. Amsden (1989:9) quotes that in 1986 the *Fortune* list of the top 500 private non-oil companies included 10 from South Korea and only 10 from the rest of all the developing countries combined. We note that this spectacular growth came at some cost of the highly exploited class. We also observe that along the growth path, mostly the working class in never well remunerated. The poor remuneration changes with a period of time last at time more than decades. The trade unions begin to demand for the right compensation.

The credit for its current prosperity goes to General Park Chung-hee who in 1961 led a military coup which established a strong state intervention in the economy oriented to the goal of rapid industrialization. He is credited with Miracle of the Han River symbolizing the miracle of industrialization and development. His rule–lasting 18 years until his assassination by his head of intelligence in 1979 was a key growth and development period of South Korea. It was during this period that it graduated from the third to the 'advanced' economies. Throughout Park's period, the 1980s and 1990s, the Korean state was the engine that was powering industrialization and economic growth. According to Rodrik (1994:61) after President Park took over in a military coup on 16 May 1961, the scope of export subsidization was greatly enlarged. The subsidy on export credits was increased and exporters were exempted from the commodity tax and the business activity tax[14].

What did the Park regime do to boost industrialization and growth?

The state undertook the following during this period:

i) It allocated resources for investment, undertook price controls, and regulated capital movements; most especially for offshore investments. Because of the legislation that had been passed in the 1960s, there was control of cash outflow. Any unauthorized overseas transfer of US$ 1 million or more was handed a minimum sentence of 10 years in prison and a maximum death sentence[15].
ii) The state shared risk and undertook and overwrote research and development especially in the development of the electronics industries. It is also was critically present supporting the semiconductor industry.
iii) The state supported planning via the Economic Planning Board (EPB). The EPB was given unprecedented powers with regard to planning for the economy. So in a nutshell there was national (state) planning common to the command economies of the East. The CEO of the EPB was elevated to the rank of Deputy Prime Minister a rank

[13] See Sung YK, (1990:5), "The Economic Development of the Republic of South Korea 1965-1981" in Lau, L., (ed.), Models of Development: A Comparative Study of Economic Growth in South Korea and Taiwan. San Francisco, CA: ICS Press
[14] Rodrik, D., (1994), "Getting interventions right: how South Korea and Taiwan grew rich", NBER Working Papers No. 4964
[15] This law was still important and feared into the 1980s – even though the state began to lose its ability to control capital to the same degree as before. See Amsden, A., (1989:17), " Asia's Next Giant: South Korea and Late Industrialization", New York: oxford University Press

that made this position second in the government hierarchy. Park regime nationalized the banking system (5 months after his coup). It should be mentioned that by 1970, the state controlled exactly 96.4 per cent of the country's total financial assets.

General Park's assassination was followed by another military coup led by Chun Doo-hwan. However, Chun's own chosen successor Roh Tae-woo, started a political reform process that led to the consolidation of pluralistic democracy after 1992.

Overall in addition to import protection, export promotion measures were also used to further industrial development for South Korea. These included subsidized credit, tax breaks, export processing zones, bonded manufacturing warehouses, duty drawbacks, privatization of customs administration and direct export subsidies (UN 2013: 128)[16].

Let's look at Taiwan: This is another Asian economy that grew rapidly. According to Lau (2002)[17], Taiwan began its industrialization drive after Hong Kong and before South Korea as a result of rising wage rates in Japan, and subsequently Hong Kong, and quota restrictions imposed by the U.S. and subsequently Europe on textile exports. It started with a high population density and with unfavourable resource endowment. It does not have the resources endowment that almost all the undeveloped Africa has. In the last century, its real GNP per capita has grown approximately US$ 6 billion to over and above US$ 300 billion; and from slightly more than US$700 to almost US$13,000 (in 2000 prices), achieving rates of growth of more than 8 percent and 6 percent per annum respectively[18]. It was not affected by the East Asian currency crisis of 1997/8 because of its large foreign exchange reserves and a low external debt.

Taiwan pioneered some important economic policies by any developing country during its growth. The most important policies for this book include land reform, promotion of family planning, export–oriented industrialization, and reliance on the private sector to ultimately stimulate growth. Land reform issues are intricate and often cause brawls but Taiwan was able to reform land systems because it was partly implemented by reformers who themselves did not own any land and did not want any land for themselves. The Joint Commission for Rural Reconstruction (JCRR) played an important role in the land reform in this country.

In Africa, efforts at land reforms have failed because the most interested parties are those allegedly instituting the land reforms.

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[16] UN (2013: 128), Human Development Report 2013: The Rise of the South: Human Progress in a Diverse World

[17] Lau, L-J, (2002), "Taiwan as a Model for Economic Development". Source: http://www.stanford.edu/~ljlau/Presentations/Presentations/021004.PDF (accessed on 12/14/13)

[18] Lau, L-J, (2002), "Taiwan as a Model for Economic Development". Source: http://www.stanford.edu/~ljlau/Presentations/Presentations/021004.PDF (accessed on 12/14/13)

The World Bank now agrees that the countries of East Asia intervened in their economies (it was not always free market economy)[19]. With the break-out of the 2007/08 global financial crisis, the world got to understand that problems of market failure are not restricted to the developing countries but also the developed one.

Role of the state in developed countries after 2008 global financial crisis

The state in USA and UK began to bail out private companies to avoid the collapse of these economies. Amidst some murmurs from the citizens, the president of USA ordered the state bailout AIG (one of America's biggest insurers) at initially US$ 85 billion, and US$ 182 billion in total[20]. Some experts blame government for having failed to keep a keen eye of the firms. That government failed on its role of regulation. This said, what emerges is that the government came in to protect AIG in order to avoid its collapse posing a danger to the financial system. Appraising the efforts to stabilize the economy 5 years later, this is what the economic advisors said[21]:

- As the world's largest insurer, AIG was too interconnected with other major financial firms and the consequences of its failure during a period of acute financial stress would have sent a tremendous shock through the global economy.
- Observers predicted any federal bailout of AIG would have resulted in substantial losses to the American taxpayers from US$36-US$45 billion. Central Budget Office (CBO) at one point estimated that the AIG bailout would cost taxpayers US$36 billion, while other estimates showed losses north of US$45 billion.
- Lacking any viable alternatives, the federal government stepped in to commit more than US$182 billion to stabilize AIG during the financial crisis. Without existing tools to resolve a large, complex financial firm like AIG, the Federal Reserve provided up to US$85 billion of funding support through a credit facility to prevent the collapse of AIG in the fall of 2008, and an additional US$37.8 billion was committed to AIG less than a month later. In addition, Treasury committed US$70 billion in two TARP investment transactions in AIG.
- The Administration took immediate steps to restructure AIG and accelerate the timeline for AIG's repayment of the government's support.
- The Administration pursued reforms to ensure that this type of bailout never occurs again. As part of Wall Street Reform, the Administration sought to put in place a comprehensive

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[19] The World Bank (1993:9). The East Asian Miracle: Economic Growth and Public Policy. Oxford: Oxford University Press

[20] "*The Financial Crisis: Five Years Later*", Executive Office of the President September 2013, Report was prepared by the National Economic Council, the President's Council of Economic Advisers, the Domestic Policy Council, and the Office of Management and Budget. (Available at http://www.whitehouse.gov/sites/default/files/docs/20130915-financial-crisis-five-years-later.pdf (accessed on 01/01/14))

[21] "*The Financial Crisis: Five Years Later*", Executive Office of the President September 2013, Report was prepared by the National Economic Council, the President's Council of Economic Advisers, the Domestic Policy Council, and the Office of Management and Budget.(Available at http://www.whitehouse.gov/sites/default/files/docs/20130915-financial-crisis-five-years-later.pdf (accessed on 01/01/14))

regulatory framework for derivatives, ensure policy makers and regulators have an effective resolution regime for winding down failed financial institutions, reduce the complexity and interconnectedness of the largest institutions, and give regulators the authority to better regulate institutions whose failure would threaten the system.

- Rather than lose tens of billions of dollars, the Administration successfully recouped the federal government's full support for AIG, along with positive returns of nearly US$23 billion. Despite widespread predictions that the American taxpayers stood to lose billions on its US$182.3 billion of assistance to AIG, the Administration successfully recouped more than US$205 billion, for a total positive return to the taxpayers of US$22.7 billion, while AIG's loan to the Federal Reserve was fully repaid.
- Key Wall Street reforms have been passed into law and are being implemented to prevent the problems that arose with AIG from happening again, including the FSOC designation of AIG for enhanced standards and oversight by the Federal Reserve.

According to this report[22], Obama administration is not unique in supporting key companies. The Bush administration also supported key auto companies.

- *The Bush Administration extended short-term loans to GM and Chrysler to keep the companies afloat.* Amid the worst financial crisis since the Great Depression, credit markets were frozen and alternative sources of financing dried up, forcing GM and Chrysler to either seek government support or face near certain liquidations. In response, the Bush Administration extended short-term bridge loans to GM and Chrysler but left open key decisions on how to address the crisis, in part to preserve flexibility for the incoming Administration.
- *The collapse of GM and Chrysler would have had a cascading effect through the American economy.* Similar to other parts of our economy, the American automotive industry has grown increasingly interconnected. The survival of the American auto manufacturers was critical to the health of its suppliers, auto dealers, and the thousands of small businesses in communities with high concentrations of auto workers. And because Ford and other auto companies depended on those same suppliers, the collapse of GM and Chrysler could have caused the failure of other auto companies as well. In fact, observers estimated that the bankruptcy of GM and Chrysler could have resulted in1 million jobs lost.

This did not happen only in the US. The British government also supported key financial companies. Britain's government offered banks like Royal Bank of Scotland, Barclays and HSBC Holdings up to £50 billion, or $87 billion, to shore up their capital in exchange for

[22]"*The Financial Crisis: Five Years Later*", Executive Office of the President September 2013, Report was prepared by the National Economic Council, the President's Council of Economic Advisers, the Domestic Policy Council, and the Office of Management and Budget.(Available at http://www.whitehouse.gov/sites/default/files/docs/20130915-financial-crisis-five-years-later.pdf (accessed on 01/01/14))

preference shares[23]. In fact this bailout money made the government an investor; what Margaret Thatcher has minimized with liberalization and divestiture of state enterprises in 1990. As the then Prime Minister Gordon Brown said "Our plan is to buy shares in the banks themselves and therefore we will have a stake in the banks. We are not simply giving money."[24]It will also provide a guarantee of about £250 billion to help banks refinance debt and the Bank of England will double the amount it lends to banks under the special liquidity scheme to £200 billion[25].

We see that all economies 'come into' the operations of the market to stabilize the economy to avoid macroeconomic instability that affects growth of economies.

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"*The Financial Crisis: Five Years Later*", Executive Office of the President September 2013, Report was prepared by the National Economic Council, the President's Council of Economic Advisers, the Domestic Policy Council, and the Office of Management and Budget. (Available at http://www.whitehouse.gov/sites/default/files/docs/20130915-financial-crisis-five-years-later.pdf (accessed on 01/01/14))

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[23]http://www.nytimes.com/2008/10/09/business/worldbusiness/09britain.html?_r=0 (accessed on 01/01/14)
[24]http://www.nytimes.com/2008/10/09/business/worldbusiness/09britain.html?_r=0 (accessed on 01/01/14)
[25]http://www.nytimes.com/2008/10/09/business/worldbusiness/09britain.html?_r=0 (accessed on 01/01/14)

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