Second Edition

INTRODUCTION TO

INTERNATIONAL DEVELOPMENT

APPROACHES, ACTORS, AND ISSUES

Edited by

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CHAPTER 7

STATE OF THE STATE: DOES THE STATE HAVE A ROLE IN DEVELOPMENT?

Anil Hira

LEARNING OBJECTIVES

- To gain familiarity with the historical context of debates about the role of states in development.
- To understand the differences between northern and southern states and why simple policy prescriptions do not seem to gain traction in the South.
- To be able to explain the differences between the market-led and state-led views of development and related debates.
- To understand the basic concepts and issues behind governance.
- To begin to understand how globalization might affect development.

WHAT IS THE STATE? THE LEGACY OF COLONIALISM

Before we get to the role of the state, we should first define it. The most prominent approaches—international relations and Weberian theory—rely on simple criteria to define the **state**: it is an entity with monopoly over the means of force within a designated territory that it controls, enjoying legitimate support for that monopoly from the majority of the population residing in the territory and recognition of its control by other states, and is empowered by the population with making public decisions.

While this definition may seem straightforward, it is problematic in a developing country context and has been accused of **Eurocentrism**—that is, being based on European experience by those who consider this experience to be normative. The most obvious problem is that states in the European context, such as the United Kingdom, developed a historical identity over thousands of years, along with slow political centralization, and in part reflect natural geographic communities (Poggi, 1978). For example, the UK's physical separation from the European continent has and continues to have consequences for its view of itself as a force independent of Europe, demonstrated by its policies towards the US invasion of Iraq and European integration. Even relatively new states such as Germany and Italy, formed in the 1870s, share a common language and cultural and religious identity as well as historical experiences, including civil wars and wars fought as a **nation**.

In the developing world, there was generally no such historical evolution. Rather, states were carved out through European conquest and division, and national identities and states were forged over short periods in response to European imperialism. In some cases, nations such as Brazil had no centralized entity that would resemble a modern state at the time of conquest. In others, genocide through direct means and population loss caused by disease imported from Europe, as happened in many parts of the Americas, wiped out large portions of the indigenous population, opening the way for the transplantation of completely new populations, including slaves from Africa. In Africa, the Middle East, and India, colonial states were created with the express purpose of mixing different populations together, a divide-and-conquer strategy that allowed colonial masters to impose a relatively privileged minority's control over a large resistant native population in spite of the relatively low numbers of colonizers in relation to local populations. In several colonies, the imposition of a new colonial elite made up of a different group from another area was added to local divide-and-conquer strategies, such as administrators from South Asia imported as bureaucrats and military officers in South Africa. In others (as in Japan's control over Korea or the British favouring the Sunnis over the Sh'ia in Iraq), the colonial masters simply chose a local minority to be their surrogates. Colonial powers planted further seeds for ethnic strife in the way borders were drawn, often across ethnic or religious lines, creating permanently divided states. The privileged locals chosen for administration formed the core of the emerging states, through power structures that often continued after independence. Thus, a relatively small external power could control a vast empire through its local allies, who then had a vested interest in the continuation of the system, whether through direct control or other ties (see Chapter 2).

While 'artificial' in the sense of not representing the natural evolution of historical and cultural identity forces over prolonged periods, the states set up by colonizers nonetheless enjoy the other aspects of statehood: control of the means of force (e.g., the army and police) and the ability to make public decisions. What they seem to lack in many cases is a strong sense

IMPORTANT CONCEPTS BOX 7.1

THE NATURE OF AUTHORITY IN THE STATE

What is the source of legitimate authority within a state? There are a number of competing theories about how a government can come to power with the acceptance of the vast majority of its citizens. While early-forming empires, such as China, were based on family dynasties, the situation was much more complex than solving the problem of political succession by family lineage. Even in China, a strong set of values based on the teachings of Confucius insisted that leadership should have a meritocratic basis and that it had a paternalistic duty to govern its citizens well. Similarly, military governments that have taken over states in the South have always given reasons as to why their actions were necessary. Thus, even in non-Western empires and military dictatorships that we sometimes deem despotic, there is a sense of the need for a government to gain popular support and acceptance (legitimacy). While not dismissing the fact that many governments also use repression, no state in history relied solely on repression.

Much of political philosophy is concerned, therefore, with the terms and means by which a state gains legitimacy. Idealized notions based on the writings of John Locke suggest a legitimate state is one in which people come together voluntarily to create a compact for mutual defence and collective action; this is why political scientists often have focused on constitutions as the reflection of political will. Others, such as Thomas Hobbes, felt that passion guides men as much as reason, and that a central authority, one with a monopoly on the means of coercion but with the agreement of the population, was the only way to create peace. With the Enlightenment in eighteenth-century Europe, which emphasized reason over tradition, a more group-oriented view of the state started to develop. For example, Jean-Jacques Rousseau suggested that the state had to reflect the collective will of the people; thus the freely agreeing individuals of Locke's perspective could be superseded by what was best for the nation as a whole. This created the idea that a state might sometimes make decisions that were unpopular in the short run but that were, nonetheless, for the general good. It also led to popular revolutions in the American colonies and in France. As the twentieth century progressed, more cynical views of the state's sources of legitimacy appeared. One set of Marxist critiques sees the state as reflecting only the interests of the powerful. These arguments reverberate today with questions about the undue influence of corporations on political decision-making. Political theorists continue to work on these ideas, with much activity going into how vibrant participatory democracies can be created, ones in which citizens participate in decision-making well beyond an occasional vote.

of **legitimacy** in terms of support among the population. This does not diminish their central role in development, but it does begin to shed light on the myriad additional difficulties that developing states face above and beyond those of Western states.

Even in states without a system of direct colonial control, the colonial economic system created incentives for compliance. Colonial economies were set up under a system called mercantilism to serve the interests of the colonizing or 'mother' country. They provided raw materials or slaves to the colonizing country, receiving the home country's finished goods in return. They were generally banned from selling directly to other countries, including colonies within the same system, thus ensuring a profit for the home country acting as a middleman. The system also stifled or shut down existing industries; in India, a budding textile industry collapsed under British pressure. For colonial elites, many of whom had nobility status and/or had been given large mineral and land rights from the colonizing or metropolitan country during colonization, their well-being depended on the system's continuation.

As colonies grew, local administrations relied almost exclusively on taxes on exports of their products, so the colonial state was very much tied into the commodity trade of the mercantilist system. This was also true in countries not directly colonized, such as China, where control by European imperial powers over trade and investment, extending at one point to dividing up control over various ports, led to a strongly dependent relationship between local Chinese administrations and European states. In many cases, outside investors controlled large and key strategic assets of the state, such as the British building and owning Argentina's railway. This system of economic control extended even after many colonies achieved independence in the post–World War II period. Thus, even though the formal mercantilist system broke down long ago, economies continue

PHOTO 7.1 Brazil has invested in oil exploration and exploitation, as indicated by these oil rigs off Rio de Janeiro.
Source: Paul Alexander Haslam

to exhibit many of the patterns of the colonial era. Those patterns include the frequent intrusion of the military into state affairs, and widespread corruption in the state. This also can be seen in good part as a colonial legacy, as the military and administration were the instruments of colonial power, reflecting the combination of force and co-optation used to control populations and extract resources.

Some analysts see this neo-colonial system as having both pressures and opportunities for state leadership. During the Cold War, for instance, the rivalry between the United States and the Soviet Union allowed some smaller states, such as Cuba, to play off the two superpowers and thereby receive large amounts of aid, in this case from the Soviets. Mainstream economists also point to the rapid expansion of the world economy during the 1960s and large US expenditures and imports as an environment that allowed for the development of the East Asian economies of Japan, South Korea, and Taiwan, the (temporary) 'miracle' economies of Brazil and Mexico, and rapid growth in states such as Kenya. On the other side of the debate, critics suggest that there is far less leeway for states to break away from neo-colonialism. The continuing reliance of many countries on commodity exports (such as Ghana's on coffee and cocoa) and on external technology, investment (highlighted by the debt crisis throughout the developing world in the 1980s—see Chapter 14), and imports, and the 'brain drain' of the best and brightest to the West are all signs of the persistent difficulty that developing states face in engendering economic development. A further difficulty is the link between military rule in much of the developing world over extended periods and the influence of outside powers, such as US support of a variety of dictators and strongmen during the Cold War.

DEFINING THE STATE'S ROLE IN DEVELOPMENT

With this historical background, we can now turn to the task of analyzing the role of the state in fostering development. At the most general level, the debate revolves around whether a state should be an active leader or a responsive follower. Part of the answer to this question depends on whether you see the nature of the state as 'compradorial' or Weberian. The term 'compradorial' was coined by radical (Marxist-influenced) development analysts to describe the ties of the developing state to external interests, whether foreign governments, investors, or military, and to the local resource-owning and internationally oriented capitalist class. Thus, this line of thinking sees the post-colonial state as continuing to be colonial in nature, run by an elite 'bought out' by and/or in alliance with foreign interests. By contrast, a Weberian view emphasizes the rational-purposeful nationalism of a modern state, regardless of its origin. Thus, in this view, even though India, for example, was created by colonial fiat, that does not prevent it from developing a government that is purposeful, rational, and legitimate.

State Capacity and Autonomy

Political economists such as Merilee Grindle (1996) have long pointed out that developing states struggle in several areas. The term 'state capacity' is often used to suggest that developing states may not be as capable of weighing technical decisions as their counterparts in the North. Their personnel may not be as well-trained; they may not have as up-to-date equipment; and their budgets are likely to be considerably smaller. The term 'state autonomy' also is often used in this context to mean the degree of 'insulation' that a state enjoys from social and external forces. The governments of states overrun with political pressures are more apt to make politically rather than merit-based decisions. In short, they may make decisions that favour a small group and themselves rather than the nation as a whole. For example, many developing-country civil services appear to lack meritocratic hiring and promotion practices. States that are insulated may be better able to resist pressures to escalate spending as a means of gaining political support. On the other hand, insulation can mean greater opportunity either for enlightened leadership or for corrupt and incompetent administration. Scholars such as Peter Evans (1995) point out that the situation is much more complex in practice. Evans uses the term 'embedded autonomy' to refer to states that develop strong network ties with foreign and domestic elites yet manage to retain some degree of autonomy for the pursuit of national interest.

Miguel Angel Centeno's study of Latin America (2002) adds other important insights into why state autonomy is so often lacking in the developing world.

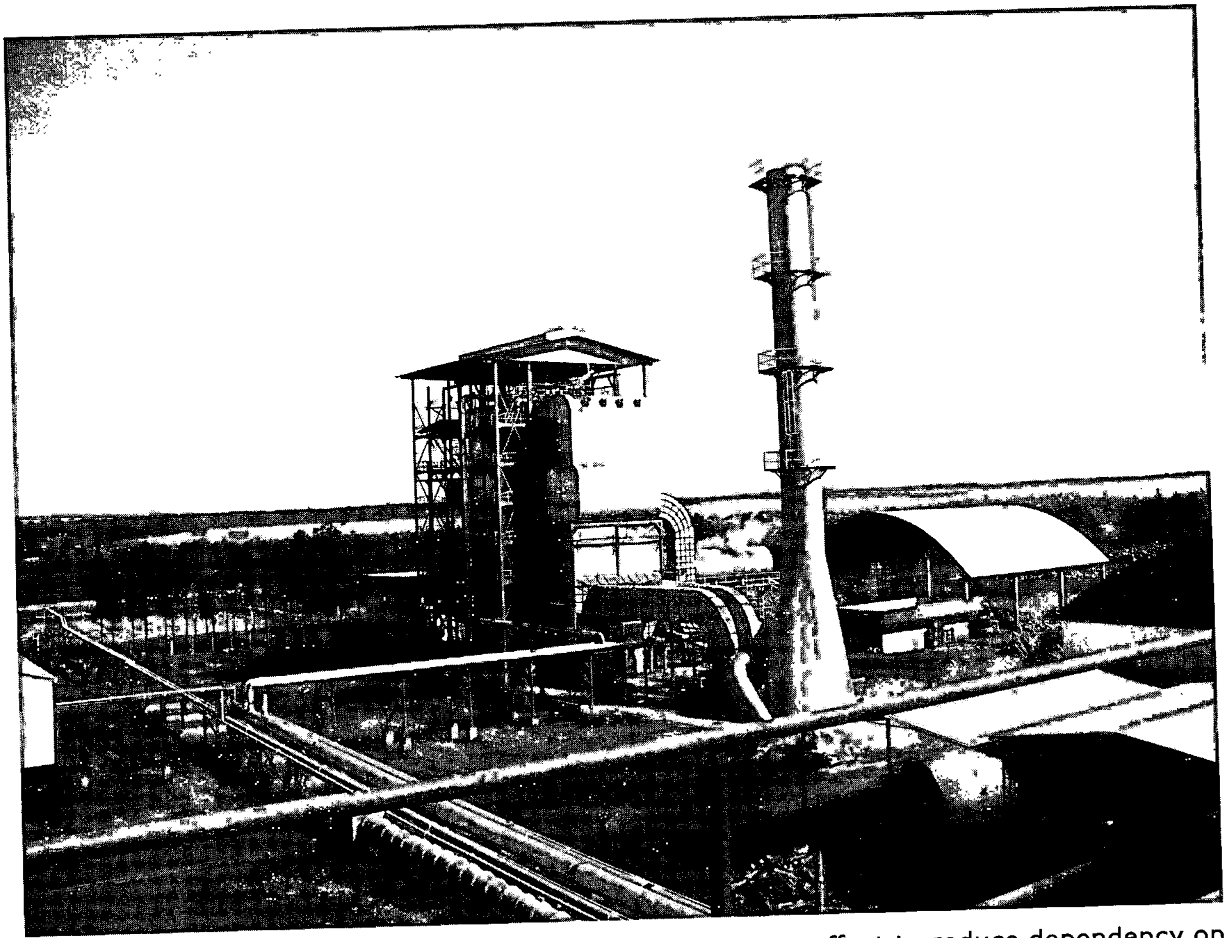

PHOTO 7.2 Paraguay has developed an ethanol industry in an effort to reduce dependency on oil imports.
Source: Anil Hira

He suggests that Latin American states lack a strong sense of nationalism, using as examples the lack of strong national cultural symbols. The symbols used to unite Latin Americans, both within borders and across the region, have decidedly mixed signals, ranging from the indigenous past (Aztec human sacrifices), and Cortés starting a genocidal conquest, to the nature of independence and post-colonial leadership (such as Bolivar, a dictator), where repression and centralized authority were used. According to Centeno, the lack of a seminal collective event along the lines of the American Revolution and its Declaration of Independence and the fragmentation and structural inequalities of post-colonial societies, by race, class, ethnicity, region, history, language, and other features, reflect and create enduring difficulties in developing a collective sense of commonwealth.

CENTRAL DEBATES ABOUT THE ROLE OF THE STATE IN ECONOMIC DEVELOPMENT

The Push for Early Industrialization

Considering the role of the state in terms of economic development opens up a more detailed level of analysis. Over the course of the twentieth century, Keynesians argued for a significant state role in managing the economy while free-market theorists (neoliberals) proposed that the state's role should be minimal (see Chapter 3).

Scholars such as Sir Arthur Lewis (1955) posited that as previous colonies' agricultural sectors were modernized, the natural labour surplus of agricultural workers would be freed to move to cities. In fact, this movement of urbanization did happen and continues today. However, Lewis also expected that the labour surplus would lower wages to the point where the natural comparative advantage of abundant labour would begin to attract industries, creating a positive cycle of growth and employment and thus no need for state leadership. In the aftermath of World War II, when many of the independent states of Africa and Asia were created, the lack of evidence for 'natural' industrialization à la Lewis led to the adoption of Keynesian-oriented policies, favoured for obvious reasons by states (because it required their leadership) and by organizations such as the International Monetary Fund (IMF), the World Bank, and the regional development banks (which two decades later would change their advice to promote the free-market approach; see Chapter 9).

In the early 1960s, the push for industrialization became one of the central goals of developing states in order to 'modernize'. Industrialization would help to diversify exports, reduce the commodity and other dependency aspects of post-colonial economies, and help to create a middle-class domestic market of highly skilled workers. However, a second basic axis of debate about the role of the state then became central: how was industrialization to be accomplished? At one extreme, many saw the Soviet Union at the time as a paradigm of efficient and rapid industrialization, accomplishing large and rapid increases in basic industrial production (such as steel) as a result of successful five-year plans. Countries as diverse as India, Ghana, Cuba, and Egypt had begun to emulate the state planning model by the late 1950s and early 1960s. The Soviet model, and later the Chinese model, was also attractive in terms of socialism—an example of state leadership in creating a more equitable nation that would correct the inequities rooted in colonialism and exacerbated by capitalism's privileging of

IMPORTANT CONCEPTS BOX 7.2

THE DEBATE BETWEEN KEYNESIANS AND FREE MARKETEERS

While many of the pioneering works of economics are based on markets and free trade, such as the work of Adam Smith and David Ricardo, the belief in markets was severely shaken by the worldwide depression marked at the outset by the 1929 New York stock market crash. The crash led to a ratcheting up of tariff walls, and as unemployment rates soared throughout North America and Europe, the beginnings of the welfare state were constructed. John Maynard Keynes (1936) gained the attention of the Franklin Roosevelt administration in the US and of various European governments by creating a new set of theories about why the market might fail, including the possibility of a liquidity trap of low interest rates and high unemployment (Hall, 1989). Keynesianism also reflected massive popular and social uprisings and demands (Polanyi, 1944). In such cases, the state should step in to 'prime the pump' by spending to reactivate the economy. The state's role in addressing 'market failures' then extended to many of the aspects of life we take for granted in the West: subsidized education and health care, unemployment insurance and pensions, and public aid for those who are not able to work. Around the same time, scholars such as the conservative Austrian economist Friedrich Von Hayek (1944) suggested that states, not markets, were more likely to fail. This view resonated during the Cold War, with fears of totalitarianism spreading from the Soviet Union and also following the diagnosis that the increase in tariffs had choked off international trade, leading to the Great Depression. As we discuss below, Milton Friedman, a University of Chicago economist, became the new champion of markets and helped to 'win' this battle of ideas in the political arena by the 1980s. Of course, with the most recent financial crisis, which began in the US in 2008, the neoliberal free-markets solution to all that ails economies once again has been found wanting—for the simple reason that markets are not simply neutral, self-operative entities; rather, they reflect all the positive and negative aspects of human individual and collective behaviour.

Source: PBS, *'The Commanding Heights'*, at: www.pbs.org/wgbh/commandingheights/.

elite classes. Skepticism, however, gradually emerged regarding the ability of the model to create viable industries or improved equity. The standard of living in Soviet bloc countries appeared to be well below that of the West, and the gap was increasing over time. Large amounts of steel did not translate into the same price for or quality of middle-class consumer goods such as automobiles. With regard to equity, the image of socialism as a benign policy for the betterment of people everywhere took a hit with the Soviet repression of rebellions in the areas it controlled, such as East Germany, Hungary, and Czechoslovakia, and Chinese repression of internal dissent. There was also growing awareness that the Communist states were creating their own coddled elites within the state party and the bureaucracy, who enjoyed a far more privileged life than the majority of the population. Finally, it is now well documented that the cost of militarization and global conflict by proxy imposed a heavy burden on the state socialist economies, particularly the Soviet Union.

Industrialization in other areas began to occupy a middle ground between market and state. In Latin America, a school of thought called 'structuralism' began to emerge (Hira, 1998). Structuralist thinkers, led by Raúl Prebisch (1950), suggested that the state was needed, at least initially, to destroy the 'bottlenecks' that prevented a market-based industrialized economy from developing naturally as expected. Prebisch, who later became the head of UNCTAD (United Nations Conference on Trade and Development), was highly influential throughout the world. One of his basic ideas, the Prebisch-Singer hypothesis, suggested that commodity prices were more volatile and earned less, over time, than industrial goods—because manufactured goods became more sophisticated (while coffee remained coffee). Therefore, developing economies needed industry to be able to reach the same standard of living as northern economies; the policies adopted became known as 'import substituting industrialization' (ISI).

Prebisch's ideas about bottlenecks refer to the foundations of any economy: its productive, financial, and labour systems. In terms of productive systems, for example, too many developing states rely on outside technology and know-how. They need to develop their own technology to avoid being left behind and having to pay for it and adapt it to local conditions.

As Gerschenkron (1962) pointed out, protectionism was part of the industrialization experience for northern states. Most developing states have poorly functioning financial systems. Because local populations do not trust their banking systems, for which regulatory oversight is generally poor (such as a lack of government-backed deposit insurance), those who can do so place their money in foreign accounts, while others have little formal means of saving or borrowing. In terms of labour systems, the poor educational systems in developing countries mean that only a small number of people are well-trained and, lacking opportunities at home, they tend to emigrate. Thus, large-scale access to higher education is needed to create viable middle-class-based economies that can function as a domestic market for goods. Prebisch also added the importance of integrating southern economies to achieve more efficient industries that can sell to each other until they can compete with well-established Western industries.

While Prebisch's ideas have been highly influential, they still leave a great deal of ambiguity in terms of how the industrialization process could best be pushed forward: where, precisely, does the state's role lie in the spectrum of possibilities between state planning and laissez-faire markets as a means of eliminating bottlenecks? On this foggy ground, a secondary level of debate has emerged. Many of the World Bank projects in the early 1960s centred on large infrastructure projects, such as airports and hydroelectric dams, which were expected to create the foundation for a modern economy.

At this time, argument ensued over whether a 'big push' or a targeted industrialization strategy would work best. Scholars such as Rosenstein-Rodan (1961) argued that a 'big push' of capital investment across a variety of industries would be needed to sustain industrialization. This idea was reinforced to some extent by Albert O. Hirschman's idea of 'linkages'. Hirschman (1971) noted that some industries, such as the automotive industry, rely on a series of other industries for production of its final product—mining and smelting to provide the steel; rubber and tire manufacturers; and a variety of other producers for inputs. It also relies on a retail network to sell the product. However, for a developing country to pursue all industrial and infrastructure avenues simultaneously might not only be impossible in terms of its financial means but also might overwhelm the technical and managerial capacity of the state. As an alternative, the state could start by targeting specific industries and then extend the effort to other industries. Japan, for example, initiated advanced industrialization with electronics, with now well-known brands such as Sony and Toshiba leading the way under state guidance. Later, the Japanese began pushing into the more sophisticated and challenging auto industry.

By the early 1970s, economists and policy-makers had become disillusioned about the state's role in development. In 1973, when the Organization of Petroleum Exporting Countries (OPEC) ramped up the price of petroleum, the world economy went into a tailspin of low growth and high inflation ('stagflation'), which Keynesian theory seemed inadequate to explain. In the short term, the situation created a large increase in liquidity in the form of petrodollars lent by newly wealthy oil sheiks to other developing countries via New York and London banks, which then used the free-floating dollar as the common currency. Yet in the long run, this rash of increased borrowing for state projects created an extremely high level of indebtedness that continues to haunt the developing world today (see Chapter 14). Determination to end inflation led the US Federal Reserve to raise interest rates precipitously in 1982. Along with a drop in oil prices, this action ended the period of easy borrowing and created a major debt crisis for developing states that had borrowed on adjustable interest rate terms in dollar denominations. With limited international borrowing and no mechanism of default (declaring bankruptcy), developing nations began to embrace or were forced into a new set of neoliberal policies, signalling the end of the era of state leadership for industrialization.

The Rise of and Justification for Neoliberalism

A number of factors lay behind the international wave of conservatism that swept the world in the 1980s. Stagflation was one factor, but on the political side, the sense of loss of power in the US and Europe also played a role. For example, the US under President Jimmy Carter had suffered a prolonged humiliation when its embassy was stormed and hostages were taken during the 1979 revolution in Iran, followed by a rescue attempt that failed miserably. These events resonated deeply with the earlier defeat in Vietnam and other historic 'losses' on the part of US allies in China, Nicaragua, and Iran itself. Conservatives pushed for a return to the 'good old days' of power and security in the North. The market-based economics they promoted was particularly appealing to many southern economists and policy-makers because it seemed to offer a solution to the new constraints on spending created by the debt crisis.

Challenges to neoliberalism sprang up almost immediately. While poverty has diminished in some areas, income inequality, by most measures, has increased in most of the world (and between the North and South) outside of the 'miracle' economies of East Asia. And are the gains sustainable in terms of the environment? Moreover, efforts to create textbook free-market models à la Chile (allegedly)—for example, in Ghana and Jamaica—led to short-term monetary stability but long-term stagnation and worsening equity (see Box 7.3).

The most serious challenge to neoliberalism comes from a wave of literature that sought to explain the precipitous rise of East Asian states and their achievements in both growth and equity. Authors such as Chalmers Johnson (1982) led the charge that the state—not markets—was responsible for these achievements. Johnson coined the term 'developmentalist' state to suggest that a state could target particular sectors for successful promotion, which would lead to improvements in equity through job creation. This concept raised the question as to why such efforts had apparently failed in the rest of the developing world. The answer is complicated, but Johnson and others suggest that the ability of the state to 'govern' the market, or to guide the domestic private sector through incentives, distinguishes the path followed in East Asia from that of other states (Wade, 1990). For example, the developmentalist state provides subsidies and/or protection only if certain performance targets are achieved and requires competition among domestic companies in a bid for state help.

Arguably, the relative dominance of the East Asian state enables it to provide greater leadership to the private sector than is possible in other regions with less dominant states (Hira, 2007). Moreover, other authors (Haggard, 1990; Gereffi and Wyman, 1990) who have compared East Asian and Latin American industrialization conclude that East Asia's export orientation represents another key difference. Export orientation means that domestic producers have to produce

CRITICAL ISSUES BOX 7.3 'THE CHILEAN MIRACLE'

In 1973, General Augusto Pinochet led a coup that took over Chile. By 1975, he had adopted economic policies that followed his largely University of Chicago–trained economic advisory team, nicknamed 'the Chicago Boys'. Chile's monetary stability, despite a crisis in 1982 and relatively high growth rates, acted as a demonstration of the ability of markets, rather than states, to lead to economic development. In the case of Chile, the state reduced legislation and regulation regarding labour unions and strikes, which the economists claimed made the Chilean labour market more flexible and adaptable (though these moves clearly also served political purposes). These legislative and regulatory changes were made possible by extreme repression of dissidents after 1973, which left thousands dead or in exile. The Chilean government also reduced many import barriers that had been set up under the ISI system to protect domestic producers, and unified and then floated, at least initially, the exchange rate. While maintaining some requirements for how long capital should stay in the country, the state also invited in foreign capital and investment. Chile went through a second wave of reforms in the 1980s, featuring the privatization of many state-owned companies (though not the copper company), including the state energy companies, to foreign interests, which would have been unthinkable in the 1960s, when anti-imperialist sentiments surged. Another major reform, also previously unthinkable, was to privatize the social security system, allowing individuals to choose their own pension funds, overseen by government regulation. Similar market-friendly reforms were carried out in education and health. Though Chile is now a democracy, the same neoliberal policies have been continued. Increased social spending has reduced absolute poverty, and there has been a successful transition of government from left-wing to right-wing parties (with both moving to the centre). Yet the success of new exports, such as fish, wood, wine, and fruit, based on state policies, has not reduced income inequalities or a strong dependence on copper exports. Therefore, the Chilean case remains controversial, both in its accomplishments and in its 'lessons' for other developing states (Hira, 1998).

goods and services that can compete in world markets. Export earnings offer a new source of revenue that the state can then funnel into new investments, including new industries, and thereby reduce pressure to borrow from abroad, as well as decrease exchange rate and interest rate volatility. However, mainstream economic institutions have not taken such challenges to market supremacy lying down (see Box 7.4). In 1993, the World Bank produced a rejoinder entitled *The East Asian Miracle*, suggesting that markets and macroeconomic balance were primarily responsible for growth, although it grudgingly conceded some role for the efficient Asian institutions that allowed markets to function well (World Bank, 1993).

From Neoliberalism to Governance

Mainstream economists, the vast majority of whom continue to support neoliberal policies because they are in line with mainstream economic theories, have begun to consider institutions an important variable for economic growth as they seek to explain the disappointing results of market reforms (Stiglitz, 2002). Economists such as Anne O. Krueger (2000), who went on to become head of the IMF, suggest that a second generation of neoliberal reforms is needed for markets to function well. The state must become an efficient market regulator, ensuring adequate contract enforcement and market-based information (such as price information); it must be capable of taxing and restricting spending; and it must be free of corruption in its decision-making. Thus, for mainstream economists, what went 'wrong' with neoliberal reforms was not the need to pare back the state and allow markets to make decisions, but simply an underestimation of the importance of state regulation for the minimization of transactions costs. Transactions costs involve running a market, such as transporting goods from buyers to sellers, and the costs of a lack of clear information,

CRITICAL ISSUES BOX 7.4 DEBATES OVER THE EAST ASIAN MIRACLE

Many scholars juxtapose East Asia with Latin America as a model for developing states (Hira, 2007). In contrast to Chile, states across the region, from Singapore to Malaysia, South Korea, and Taiwan, have achieved both sustained growth and high levels of equity. Key to the early achievements was land reform in Japan, South Korea, and Taiwan. East Asian states have invested heavily in improving the educational and health levels of their populations across the board. They also have focused on 'moving up the ladder' (Chang, 2002)—that is, starting out by exporting labour-intensive goods such as textiles and moving gradually towards more sophisticated goods such as computers. Alice Amsden (1989) suggests that East Asian states have created a system of learning new technologies and improving production processes in order to enter into new and more sophisticated industries over time. Other scholars, such as Frederic Deyo (1987), are more critical of the record, citing repression of labour as one of the key features of East Asian growth. The latest case, China, is also controversial, exhibiting miraculous growth and poverty reduction over short periods of time but, unlike its neighbours, with high levels of regional and class inequalities and increasing environmental concerns.

which creates uncertainty and risk, and the lack of standards (an example would be appliances that run on different voltages). So, the second generation of reforms, particularly developing sound judiciaries to enforce property rights and contracts and to eliminate corruption, is really the key to spurring development in the South. According to this view, while the state regulates to reduce transactions costs, it cannot replace the market as the primary economic decision-maker.

The World Bank has picked up on this theme, using the term **governance** to refer to its new-found concern with how well states function in managing markets. It is interesting to note that this new tack still allows economists to avoid overtly political analyses (see Chapter 9). Governance thus came into the debate to encompass a variety of attempts to reform the state since the 1990s. Like globalization, it has been used in different ways and contexts to mean different things. In the most general sense, the idea of governance developed in response to the crisis of the state caused by neoliberal market-friendly policies. Shackled with debt and forced to retrench, the state lost its role as the leader in economic development. Even in welfare programs and utilities, privatization, subcontracting, or **public–private partnerships** are viewed as superior to the post–World War II Keynesian state, which was disparaged for the economic crises of the 1970s and 1980s. On the other hand, the general lack of economic growth and worsening income distribution between the North and many parts of the South led some to re-examine state and international organizational capacity for development.

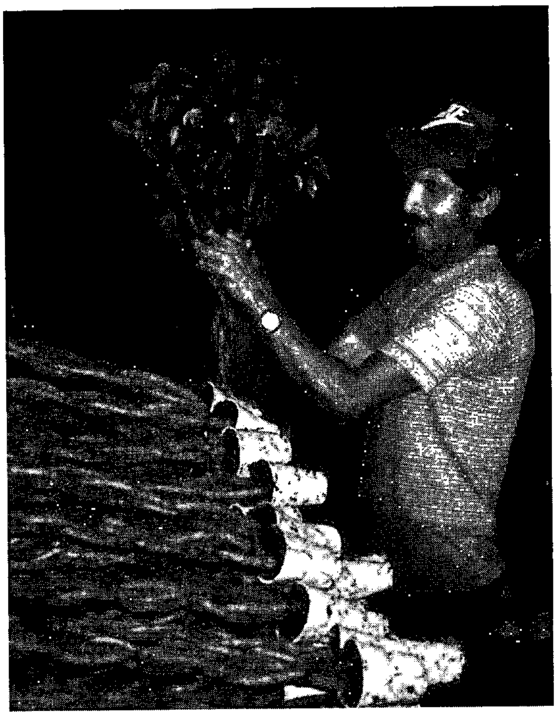

PHOTO 7.3 Worker preparing small ornamental fig trees for export, Las Palmas, Canary Islands.
Source: Jean-Marc Fleury, IDRC

Rent-Seeking and State Capture: The Battle against Corruption

The idea that the state was the problem with—not the solution to—economic development resonated with many people who had seen colonial states transformed into patronage-heavy and highly inefficient public projects and enterprises. Scholars such as Krueger (1974) coined the term 'rent-seeking' to describe how states, even in the North, could become 'captured' by special interest groups in the private sector, leading to policies that benefited a privileged minority. The charge of state corruption had broad appeal in the South and led initially to the success of neoliberal populists such as Carlos Salinas in Mexico, Alberto Fujimori in Peru, Fernando Collor de Melo in Brazil, Carlos Andres Pérez in Venezuela, and Carlos Menem in Argentina. The fact that all these leaders were later pushed out on corruption charges helped to sour the popular appeal of neoliberalism but did not eliminate the central problem of state capture. State capture now often includes the idea that powerful private interests, such as, but not limited to, foreign corporations, can undermine the ability of the state to pursue national policies in the collective interest and thereby undercut the democratic process.

The focus on good governance for mainstream development agencies has meant a battle against corruption. Various scoring indices have been developed for an annual rating of the level of corruption of a country; the most well known are those of Transparency International, the World Bank, and the World Economic Forum. The data for these exercises are largely gathered from surveys of international business executives. While valuable, indices based on such a limited and understandably biased perspective only tell a part of the story, that is, how 'friendly' a particular country is for the interests of international business, such as full profit repatriation, which might not be in national interests.

The focus on good governance does not just stop at how conducive to business the social and political environment is in a particular country. Most development agencies have adopted some form of 'results-based management' and, at least rhetorically, a recognition of the need to consult stakeholders. The Millennium Development Goals, adopted in 2000 by a wide range of multilateral and bilateral aid agencies, were designed to create some clear, measurable targets for donor assistance levels, results to be achieved (such as the wiping out of certain diseases) over certain periods of time, and the requirement for good governance by recipients.

To date, there is not much promising news on any of these three fronts. The problems of good governance and corruption seem to extend well beyond just a lack of will to put the development goals in place. What may be normal in one place, such as allowing a friend speedier service, may be viewed as corruption in another. For example, Robinson (2009), reflecting findings by others, relates how a serious overhaul of the civil service in Uganda, including raising salaries and creating anti-corruption agencies and independent revenue authorities, had initially promising results but ultimately ebbed into failure. More ironically still, strong evidence indicates that donor agencies and NGOs suffer from a lack of accountability and transparency (Berkman, 2008; Cremer, 2008).

Thus, it is important to distinguish **clientelism** from corruption. Clientelism is favouritism for particular groups that may be perfectly legal (unlike corruption) but inimical to social interests. Continual scandals in the North, from the fraudulent accounting that led to the collapse of US companies Enron and World.com in 2001–2 to the legal but destructive trade in derivatives by Goldman Sachs and others in 2009 have brought a new wave of interest in corporate ethics. Moreover, a review of corruption indices over time, such as that of Transparency International, shows little movement from high to low corruption, and offers no real explanation for why corruption occurs. We know that some 'developing' states, such as Singapore, Hong Kong, and, to a lesser extent, Chile, rank quite well in terms of perceptions of corruption, but we don't know why or how these can be replicated. All of this indicates that much deeper (possibly cultural and political) roots are at play in the fight against corruption and clientelism, and that it is a universal, not an exclusively southern, problem that deserves a lot more attention.

GOVERNANCE AS A PROCESS OF DEMOCRATIZATION

For non-economists, 'governance' has come to mean a wide variety of other things related to a supposed crisis of the state throughout the world. The crisis of the state in the North refers to the lack of interest and electoral participation among large segments of the population, as well as a supposedly growing cynicism about the increasing reach of the state over the course of the twentieth century. In the South, the crisis stems from the fragility of democracy, as well as dissatisfaction with the ability of democracies to address long-standing structural inequalities. Therefore, the original economic definition of 'governance' that focused on good regulation of markets is now matched with an emphasis on finding additional means of enhancing the participation of citizens, called 'civil society', as individuals and groups in collective decision-making through state co-ordination.

For most economists and in practice, this evolution has meant state co-ordination with the private sector. Studies have suggested that greater civic and political engagement ('social capital') leads to higher economic growth and development (e.g., Putnam, 1993). Certainly, southern democracies have a host of deficiencies, ranging from common voter fraud to extremely weak opposition parties and judiciaries. These shortcomings have been viewed as both reflecting and exacerbating the often polarized nature of their polities. This line of thought led to a different use of 'governance' to mean co-ordination of collective decision-making among stakeholders, and had profound effects on development policy-making and practice, which now actively solicited outside parties (the stakeholders, generally limited to certain acceptable points of view) to take part in the decision-making process, including civil society or the general public. Such an approach is different from allowing only well-organized and well-funded lobby groups into the decision-making process. Thus, the state becomes as much a facilitator as a leader. In theory, all those affected have a say in collective decision-making, and the process is as important as the decision itself. For example, experimentation with participatory budgeting in certain municipalities in Brazil is seen as a new model for how to govern. The emphasis on client-based and results-based management is essential to what is called the 'new public management' approach.

In practice, such noble efforts are quite difficult to consummate. This new kind of open state requires a new level and set of skills in terms of state capacity that go well beyond simply posting information on a website. Even on the local level, where participation is easier, studies show that those with more means tend to participate more. Similarly, gender, ethnicity, literacy, and free time could affect rates of participation. Then there is the question of how to deal with highly technical issues, such as how to best set the central bank interest rate. Moreover, the general public could be wrong—for example, in underestimating the long-term costs of climate change. This version of governance aims (or claims) to enable equitable representation of the different segments of the population, as well as to weigh collective interest in decision-making. Yet strong critiques suggest that governance of this sort is impossible, given the structural inequalities rife in the South.

On the other hand, others hold hope that a more open system will increase transparency and accountability to previously unheard constituents. This sea change of thought is behind the new forms of democratic populism, such as the attempts by Venezuela and Bolivia to create new constitutions and more representative constituent assemblies in the past decade. For an external agency, taking local participation seriously potentially changes the whole way that development operates, from defining a mission to delivering resources to evaluating the 'success' or 'failure' of a project, and the same could be said of any public service in general (Hira and Parfitt, 2004).

The 2008 worldwide financial crisis further polarized both sides of the governance debate. One side, reflected in much of economic thinking, believes that the state has grown far too large, impinges on economic activity and individual liberty, and has been captured by 'special interests', a code word for lobbying groups. The other side sees the financial crisis as having brought into plain sight the recklessness of the neoliberal faith in the self-regulating capability of markets and as having highlighted the need for more state intervention and control, not less. The debate has been played out in developments around the world, and can be readily seen in the polarized political climate of the US and other countries. These changes lead some to claim we are now in a post-neoliberal era, with a different kind of state evolving, while others see changes as mere modifications to an essentially market-based model (Macdonald and Ruckert, 2009).

Globalization and the Role of the State

Concern about representative accountable states that are engaged with equity as well as growth has increased in a globalizing world. By globalization, authors such as Manuel Castells (1996) refer to increasing economic and social transactions and ease of communication across states. The explosive power of the Internet demonstrates the way that states may be losing some aspects of their control—in this case, the ability to control information and the means of communication within a state territory.

In addition, the movement towards policies that encourage foreign investment has been paralleled by the increasing dominance of large global companies such as Microsoft and DaimlerChrysler. Some argue that these companies have no real national identity, provide few benefits to their home country, and drive hard bargains with the developing states that want to attract their activities. Meanwhile, their headquarters and sales offices remain concentrated in a few key areas—namely, the 'quad' (Canada, the US, Europe, and Japan) (see Chapter 11).

There is even greater fluidity in financial transactions. Much of the world's financial transactions now take place 'offshore' in small tax havens, such as the Cayman Islands, where terrorists, drug traffickers, and corporations share banks. While most financial activity continues to occur in New York and London, the offshore centres serve as important routes to tax evasion. During the 1980s, part of the neoliberal reforms involved setting up stock exchanges in much of the developing world. The expectation was that these emerging markets would be able to attract increasing amounts of capital for their cash-starved growing businesses; markets, not the state, would provide leadership, taking on the risks and the analysis required to develop new businesses. However, the experience with emerging financial markets has been less than stellar. For example, there has been some 'contagion', meaning that the collapse of one stock market, such as Russia's in 1997, creates a domino effect leading to the collapse of other developing markets.

Questions also have been raised about the international trade agreements that multiplied during the neoliberal period (see Chapter 15). For example, NAFTA, signed by Canada, the US, and Mexico in 1994, was supposed to lead to an age of prosperity for Mexico because its comparative advantage—cheap labour—would be soaked up in US production chains. However, the effects of NAFTA on Mexico have been highly controversial. Critics suggest that only a limited number of low-paying jobs have been created and that many sectors, such as sugar cane production, have been adversely affected. They also note that with China's emergence, many of the labour-intensive industries have left Mexico and relocated in a lower-wage environment. Moreover, products such as computers are manufactured in a modular fashion, with components that can be sourced and assembled in many different locations. All of this has led some to suggest that the state has weakened in the face of

CRITICAL ISSUES BOX 7.5 — GLOBAL CHAINS OF PRODUCTION

In 2005, *New York Times* journalist Thomas L. Friedman released a blockbuster book entitled *The World Is Flat*. Friedman suggests that global chains of production create a 'level playing field' through which developing countries will start to participate fully in the world economy. Friedman points to the recent experience of Chinese and Indian companies springing up to compete in world markets, and uses as an example the production of a computer: programming may be done in one place, while the manufacture of components, the assembly, and the testing are done in several other locations. This modularization of production is what some scholars long ago signalled as global commodity chain production. Friedman sees the rapid development of global production chains as largely beneficial, leading to greater participation and reduced poverty as well as reducing prices for consumers. Expansion of this participation means larger world markets, so employment does not have to decline in the West. Some scholars (Gereffi and Korzeniewicz, 1994) note that the nature of the product and what parts of the production chain countries are able to capture will determine the earnings they receive. For example, we pay some $4 for a fancy coffee at Starbucks, but coffee farmers in developing states receive a tiny fraction of that amount. This discrepancy has led to the current fair trade movement, but arguably, states are responsible for finding ways of making their economies more competitive and for capturing more of the revenue and jobs.

globalization (Strange, 1996). Some critics even suggest that the state is dying, not only in the developing world but also in the developed world, and point to diminishing social welfare protection in many states as evidence.

Yet other analysts, such as Linda Weiss (1998), argue that such ideas are 'greatly exaggerated' and that the state is more important than ever. The state still determines the rules for foreign investment and trade within its own territory. The state is still the dominant actor that chooses whether to trade and fixes the terms for signing international trade and investment agreements. The state still can improve the nation's ability to compete in global markets through strategic investment in infrastructure and its own people. We can observe that, as in the story of blind men describing different parts of an elephant, both perspectives are correct. Globalization has weakened labour protections and labour power across the North as labour-intensive manufacturing has been replaced by cheaper imports of manufactured goods from overseas, where labour regulations and enforcement are less stringent. This does not mean that developing states that capture new production are in control, because production can move from one country to another fairly quickly in response to global business supply decisions. For example, textile production has moved from Mexico and South Korea to China and Central America. At the same time, several analysts argue that strategic state intervention, not markets, explains the ability of states such as China and India to attract new global industries and services (Hira and Hira, 2005). Certainly, the state still may choose to create forms of insulation from and adjustment to global forces—Malaysia, for example, imposed controls over the movement of capital from outside the country for many years. Thus, the role of the state remains at the forefront in the development debate.

SUMMARY

Arguably, the state as an instrument of the public will is at the centre of most development debates and action. The state is the arena where political, social, and economic debates and conflict are played out in terms of which public policies are adopted and implemented. The state is highly controversial, with some seeing it as an instrument for preserving the concentration of benefits, while others believe it is the sole instrument capable of leading a nation forward for the collective interest. This chapter has explored the role of the state in economic development through historical, discursive, and empirical analysis. Contemporary issues such as globalization and the call for better governance are central to this discussion. A number of case studies exemplify questions regarding whether the state can and has been a positive force for economic development in the South.

QUESTIONS FOR CRITICAL THOUGHT

1. Is the traditional international relations theory view of a state adequate to understand the types of states we find in the developing world? Does it vary by region?
2. Select a developing state and identify the major issues it faces by examining current news reports. Then examine something about its history (a basic on-line encyclopedia will do). To what extent are its current problems tied to its colonial origins?
3. What are the advantages and disadvantages of market-based as opposed to state leadership? Consider efficiency and equity outcomes, economic stability, and employment.
4. If you were a state planner, what arguments could you see for and against a big push versus a targeted strategy for development? What kinds of blockages can you see in a typical developing economy, and to what extent are they related?
5. Is there a disadvantage to producing commodities instead of manufactured goods? Why or why not?

6. Why is the issue of corruption so polarized, with some claiming that it is at the heart of poor development performance in the South and others suggesting that it is just a way for external agents to ensure their investments in the South are safe? How would you judge the merits and weaknesses of each explanation, and what is your perspective?

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Development Gateway
www.developmentgateway.org

PBS, *'The Commanding Heights'*
www.pbs.org/wgbh/commandingheights

Transparency International
www.transparency.org

United Nations Industrial Development Organization (UNIDO)
www.unido.org

World Bank
www.worldbank.org

World Economic Forum annual competitiveness report
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