The State and Development

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Abstract

The state and development is a critical issue in speaking to contemporary debates about whether prosperity is best served by small or large government. The definition of foundational versus cutting-edge research differs depending on whether the discipline is economics or sociology. There was an early agreement that government should be big for "big pushes" or "modernization." Economics turned antistatist as a reaction to Soviet planned economies and to corruption in general. This led to a neoliberal attempt to create growth by shrinking state programs—an initiative that failed very badly. New work in economics emphasizes flexible approaches as to what states should do, promotes states building education, infrastructure and encouraging technology transfer, and puts great weight on institutional quality. Sociology emphasized the state as a protector of poor nations from the predations of international trade and multinational corporations. Emphasis was placed on hard bargaining by states in the Global South and in developmentalist states such as those in East Asia, which administratively allocate public investment monies to overcome inefficiencies. New work suggests that more modest programs emphasizing simple public goods can be effective. Emerging work also questions traditional specifications of the adverse effects of international trade leading to a different set of suggested remedies. Future directions need to focus on palliative development—strategies of state development that build the multiplier effect rather than base industries. Methodologically, within nation studies that residualize employment from market factors offer ways to identify new government programs that are effective.

One of the most fundamental issues in macrosocial science is the role of the state in producing development. The question is not whether the state should be big or small. Military imperatives are sufficient to guarantee that the state will be big—for reasons of geopolitics in the core and for reasons of regime maintenance in the periphery. The question is given a big state, what can or should such a state do to guarantee development? One reason to ask such a question is political. Candidates for election promise the voters that they can generate economic growth and prosperity. Once they attain office, they are expected to use the state apparatus to deliver on those claims. More so, net of promises, if the elected politicians wish to do *anything* once in office,

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revenues are required in order to implement any program of governance. The state must promote economic growth in order to maintain its own finances (Block, 1987).

The question of the state and development is also humanitarian. Most of the nations who have industrialized effectively and raised their Human Development Indicators to an adequate level have done so on the basis of some form of effective government policy. Explaining how this is done is important in providing guidance to poorer nations who wish to do the same.

The debate about the state and development is also important from an intellectual standpoint. The fundamental debate between economics and sociology as disciplines has been about the comparative role of free markets versus institutions in shaping social outcomes. The optimization algorithms of economics are based on an assumption that the rational decisions of individuals making personal economic decisions aggregate upward to a market result that represents Pareto-optimality—namely, no one would be better off if any decision were made other than that the market generated (Pareto, 1971). Yet, it is well known that states take actions that have political consequences. These actions are determined by administrative and political rather than market processes. If states outperform free markets, this raises questions about whether free markets are optimizing mechanisms at all; if states always underperform a free market, this gives greater credence to the foundational principles of neoclassical economics.

In this discussion, "the state" will refer to the administrative policies that produce economic growth, either intentionally or unintentionally. For reasons of space, we will not discuss questions of macroeconomic management such as monetary policy. The discussion here gives greater emphasis to government "growth-related" programs such as state-led development, providing physical and human capital infrastructure.

"Development" is used in the traditional sense of GDP/per capita. Development is a contested concept—and questions emerge between very real contradictions between GDP/capita, the socially constituted "development project" as capitalist ideology, ecological integrity, and the protection of exploitable groups such as indigenous people or the poor (McMichael, 1996). These questions are vital but require too extensive a treatment to be considered fairly here.

FOUNDATIONAL RESEARCH

The allocation of work in this area between foundational and cutting edge is complicated by the fact that economics and sociology adopted different lines of thinking at different times. What was foundational in one discipline was rejected by the other, and what was cutting edge in one discipline was old and familiar in the other.

Midcentury, there was somewhat less of a divide between development economics and development sociology on this point. Development economists favored "a big push" in which the state would coordinate simultaneous investments in infrastructure and capital goods industries as a way of providing "everything an economy could need" all at once (Higgins, 1959; Rosenstein-Rodan, 1943). The argument was that poor nations are so poor that no rational investor would invest in the large projects needed to jumpstart industrialization. Only the state could generate confidence in private capital markets by showing "so much positive change" was occurring that previously nonviable investments were now feasible.

In sociology, modernization gave the state a parallel role. Here the emphasis was less on investment in infrastructure and basic goods and more on breaking the cultural limits imposed by traditionalism and particularistic "tribal" loyalties. States produced "modern attitudes" consistent with Weberian rationality and technological growth by promoting Western education, secular values, bureaucratic rules of universalistic administration, rule of law, and the use of money and credit; they also created political entities and markets large enough to be able to sustain the scale necessary to support economic growth (Hoselitz, 1952; Parsons, 1971). The state provided a big push, which was cultural and institutional.

However, over time, the economics profession moved toward a position of strong preference for market forces and general hostility to the intervention of government into the economy. Some of this derived from respect for the power of the price mechanism in conveying information and concern about any bureaucratic setting of prices that would interfere with prices being a simple indicator of bona fide costs (Friedman, 1962). Some came from the empirical observation of the consistently poor performance of state-run command economies in the Soviet bloc. Another source of skepticism was the pervasive corruption and clientelism that could be found in some Third World governments.

Various purely theoretical models were developed in the Hayekian tradition showing that government expenditure and taxation produced deadweight losses for society (Ballard, 1985). However, the literature that had the most impact on development economics was the political economy or "rent-seeking" approach. Government bureaucrats were assumed to be corrupt profit maximizers whose public office gave them monopoly control over a product or service. They administer their office to maximize their income from "rent payments"—a polite way of saying bribes. Note that rent seeking involved a full range of rewards to private officials for the distortion of public policy. Above and beyond simple bribes, there was the intentional fomenting of clientelism through creating opportunities to "solve problems" for constituents, and the self-interested expansion of the budgets and powers of government offices for simple political reasons. The theories would then specify the loss in national output or welfare that came about because of this corruption (Krueger, 1974; Posner, 1975). One implication of this framework was that the government bureaucrats would put as many administrative obstacles as possible in front of citizens and entrepreneurs to maximize potential opportunities to collect side payments—and these regulatory obstacles would also impede firm formation and investment simply from the red tape required for law-abiding citizens to get things done. Empirical support for this world view came from the work of Hernando De Soto whose 1989 *Other Path: Invisible Revolution in the Third World* painted a grim picture of bureaucratic obstacles to doing business in Latin America. Subsequent research showed that de Soto's nightmarish account of stifling government red tape was highly exaggerated and that the time and cost for small Latin American businesses of compliance with government regulations was relatively modest (Tokman, 1982).

The antistatist bent of development economics became manifest in the Washington Consensus and the rise of neoliberalism (Williamson, 1990). The fall of the Berlin Wall emboldened state-haters. Just as Communism falling represented the realization of a miraculous dream, the removal of all government interference with the economy in the Third World now seemed like another potentially reachable miraculous dream. Development economists recommended a program of reduction of state budgets, privatization of public firms, deep cuts in the social safety net, and elimination of tariff barriers, limits on foreign ownership of local assets, and repatriation of capital (Sachs, 1994).

Sociology has generally had a prostatist rather than antistatist orientation caused by an intrinsic concern for the adverse effects of market forces on growth in peripheral nations. This position has been put forward by dependency theorists (Frank, 1967) and world systems theorists (Wallerstein, 1974); the adverse effects of international trade received particularly cogent formalization in the theory of unequal terms of exchange, popularized by Samir Amin (1976). Amin argued that trade between rich nations and poor nations involves exchange of high-tech manufactures that involve proprietary knowledge, for commodities that are technologically simple and can be produced by a wide variety of nations. This allows the rich nations to charge monopoly rents for their products, while the prices of agricultural and extractive commodities are kept low by global competition for sales and market pressure The core manufacturer is a price maker and the peripheral farmer is a price taker; the result is a substantial transfer of resources from the periphery to the core. The outflow of resources from the periphery to the core has been exacerbated by foreign direct investment; multinational corporations in the Third World tend to repatriate profits from their third-world subsidiaries to their home operations in the developed world (Barnet & Muller, 1974).

Thus most postdependency theory models of the state and development in the Global South argue that the state promotes economic growth by constraining market forces for the benefit of peripheral nations. The most famous of these models is that of Peter Evans. In *Dependent Development* (1979), Evans argued that Brazil developed by having the state engage with hard bargaining with multinational capital. The state limited the ability of foreign companies to repatriate capital. Most multinational investments involved tripartite deals between foreign capital, local capital, and the state bureaucracy—with the government maintaining partial control of the investment either through state ownership of a portion of the company or through the state controlling access to capital via public development banks. The state also acted as an entrepreneur, creating and maintaining total ownership of a number of strategic industrial companies, notably those in steel manufacturing and oil production.

Another state strategy for limiting adverse market forces has been protectionism. Tariffs and import restrictions limit the capacity of the core to sell monopoly priced manufacture goods, reducing the most important source of loss of capital. Tariff protection has two further advantages. It provides protection for infant industries. Moving from an agricultural to an industrial economy requires that the agricultural nation learn the technology associated with manufacturing. There is typically a learning period associated with this when the peripheral nation's goods lack the quality to compete against foreign producers. Tariffs restrict foreign competition and give the local companies time to gain the skills necessary to produce a quality product. This theory originated in the work of Alexander Hamilton (1789) and Friedrich List (1983). Ha-Joon Chang (2008) has shown that most prosperous economies including Britain and the United States made extensive use of tariffs and import restrictions in the early phases of their industrialization. It has been suggested that import substitution regimes led to indebtedness caused by the intrinsic unintended consequences of price distortions and government expenditure to support inefficient local enterprise. Fishlow (1990) debunks this proposition thoroughly showing that the debt problems of early import substitution states came from exogenous expenses in nondevelopment programs such as the military and the welfare state.

However, the most intensive intervention of the state into the market is the East-Asian developmentalist state. The East-Asian economies have grown faster than any other economies in the history of capitalism. Their success is largely attributed to state programs of direct administrative channeling of investment funds into strategic sectors of the economy chosen for their potential to produce long-term growth (Amsden, 1985; Wade, 1990, Woo-Cumings, 1999). In some cases, this is achieved by state ownership of strategic industries, such as the Taiwanese chemical industry. More commonly, it is achieved by state ministries or development banks offering highly subsidized credit and profit guarantees to firms who invest in industries selected by the government's own strategic planners. In other cases, the state subsidizes strategic inputs such as electricity, steel, or fertilizer to firms following official economic development policy.

These policies are often accompanied by state policies of accelerated technology transfer. These can include investment in basic or university education, subsidizing local students studying overseas, funding for basic and applied research, and requirements that foreign corporations share proprietary technology as a precondition for producing in the country (Amsden, 2001).

The dramatic successes of these interventions have motivated sociologists to treat the East-Asian state as the beau ideal of successful developmental policy, with less developmentalist alternatives being treated as at best, partially adequate and at worst, pathological (Chibber, 2006; Lange & Rueschemeyer, 2005).

CUTTING-EDGE RESEARCH

What is cutting-edge research is different in economics than it is in sociology. I consider the sociological case first. Note also that "new inconvenient" research has often been published earlier than 2010. Findings in cognate literatures often do not find their way into the local debates where they would make a difference. In addition, inconvenient findings are often "unrecognized" or "buried" by readers who wish that these unpleasant truths had not surfaced.

The biggest unpleasant surprise that macrosociological development theorists will have comes from Jeffrey Williamson's (2006) *Globalization and the Poor Periphery Before 1950*. Jeffrey Williamson has two unpleasant messages for old school world systems analysts. He did a statistical analysis of economic growth during 1870–1950 using a newly available dataset from Angus Maddison on world GDP by nation state from 0 AD to the present era. This new dataset is attracting a lot of attention, being worked on by many scholars—including the present author. Williamson is an economic historian of some renown and has spent a substantial proportion of his career creating a dataset of the history of terms of trade and tariffs for a representative subset of Maddison's nations (tariffs for nearly all nations, terms of trade for a large group with equal shares of wealthy and poorer nations).

Maddison found that adverse terms of trade *increased* rather than decreased industrialization. The old theory suggested that trade hurt the periphery because adverse terms of trade drained resources to the core. In fact, growth is significantly correlated with having low-priced local agricultural commodities and relatively expensive imported manufactures.

The news about tariffs was equally discouraging. Within individual regions, high tariffs were often—although not always—correlated with economic growth. However, some regions existed where the opposite occurred. Worse was that Latin America has historically had the highest tariffs of any region in the world and yet has generally experienced mediocre growth rates. Protecting nations against adverse terms of trade—or against the adverse effects of trade openness—does not seem to be important in stimulating growth.

The finding of weak effects of tariffs is not a fluke. Stalling and Peres (2000), in an analysis of the effects of increased trade openness on economic growth in Latin America, found that openness had mixed benefits. South American firms that were already strong become stronger with more international opportunities and firms that were weak declined.

The Williamson findings suggest that what is harmful about international trade is not resource draining to the core, but the weakening of demand for local manufactures. When export agriculturalists had favorable terms of trade (high agricultural prices and cheap foreign imports), they used their commodity profits to buy foreign assets and consumption goods. The multiplier effects of successful export agriculture in the periphery went to manufacturing firms in the core. When Amin's adverse terms of trade existed, agricultural prices were low and foreign imports were more expensive. The local agrarian elite could not afford foreign luxury goods or foreign investments. Thus, they were forced to consume and invest locally. This built up the demand for local manufactures and supported home-grown industrialization. Note the tariff data does not rule out this interpretation. For wealthy elites, the tariffs on imported luxuries were a relatively small component of costs. Resource booms and high-commodity prices created agricultural fortunes for which tariff walls were probably a trivial consideration. It was the lack of agricultural money and not tariff walls that got the agrarian elite to buy local.

Sociology's heavy focus on the developmentalist state has been challenged recently in work by Cohn (2012) on Brazil. As a strategy, the developmentalist state is effective but fragile: it requires an extreme set of preconditions to work, such as a technocratic bureaucracy and a fiscally solvent state with only limited penetration from private capitalist interests; in the absence of these conditions, "pseudo-developmentalist" states become corrupt and clientelistic (Chibber, 2006). Fiscally sound, independent, fully technocratic states are the exception rather than the rule in the global south. What is the rest of the world supposed to do?

Cohn studied employment in three labor-intense, medium-wage industries in Brazil: hotels, restaurants, and barber/beauty. The primary finding was that state infrastructure and vocational education programs created significant employment gains in these sectors. Airport construction had particularly dramatic effects—and these spilled over into other sectors of the economy as well.

The findings of high infrastructure and education effects strangely echo a "classic cutting edge" work written in 1973, James O'Connor's *Fiscal Crisis of the State*. That work had been central for introducing the concept of monopoly and peripheral capital in advanced capitalism to American Neo-Marxism; however, its importance as a theory of development had been minimized, particularly for peripheral nations. O'Connor argues that capitalist states promote economic growth by providing public goods that would not otherwise be provided by the capitalist class themselves. These public goods involve projects of enormous scale, projects that are unprofitable over the short term, or projects that provide benefits for other sectors. He explicitly listed education, transportation infrastructure, basic scientific research, defense and public welfare (as a legitimation device) as state contributions to capitalism. The Cohn Brazil findings show that these state programs do provide meaningful employment—and can be provided with a fraction of the financial cost and state autonomy of a full-fledged developmentalist state.

In economics, the cutting edge came from the poor performance of neoliberal policies in producing growth. Shock therapy in Russia did not eliminate clientelism. After the East-Asian financial crisis, the countries that recovered the fastest were those such as Malaysia that did not shrink the state or practice fiscal austerities (Stiglitz, 2002). Latin American employment stagnated (Fernandez-Arias & Montiel, 1997; Stallings & Peres, 2000). All the while, developmentalist East Asia continued to show robust growth.

This led to a rethinking and the rise of three more state-friendly approaches to the development issue. The first is that of Joseph Stiglitz (2006). Stiglitz argues for a multi-faceted role of the state. Like O'Connor, he is a strong advocate of spending on infrastructure, education, and basic scientific research. He is also an advocate of strong regulation to reduce financial fraud and speculation. He further argues that state policies of redistribution of income from the rich to the poor are necessary to put on a floor on consumption levels and thus support national levels of aggregate demand. This position is now sufficiently mainstream as to be advocated by the World Bank (2002).

The second innovation is Dani Rodrik's (2007) rapprochement between developmental statism. Rodrik made several innovative arguments. The first is that economists err by diagnosing a potential economic pathology in theory and assuming all economies are at risk because of this one problem. As the title *One Economics, Many Recipes* implies, there are many conceivable roads to development—and what one society has too much of, another society can have too little of. A contrast between Brazil and El Salvador showed that proconsumption policies were needed in El Salvador but prosavings policies were needed in Brazil. This concern with multiple pathologies led Rodrik to argue that developmental states need to be diagnosticians figuring out exactly what was wrong with their economy and custom tailoring a unique institutional solution to local obstacles to growth. In doing so, he identified a complex list of problems that can be solved by government including problems in the transfer of technology, problems in obtaining capital and "administrative failures" in which private sector investments can only occur if the business community is assured that certain other changes will be made simultaneously to valorize their investments. Another key innovation was the argument that state developmentalist programs should be short term rather than permanent fixtures. Profit guarantees work better if they are for a fixed duration with a known expiration year. Making policy temporary eliminates long-term clientelistic dependency on state handouts—and insures a fresh reconsideration of all programs in the light of changing market conditions.

The third change was a broad-based affirmation of the importance of institutional quality. This line of argument has its basis in Douglas North (1990) who argued that secure property rights, rule of law, freedom from arbitrary seizure, and fair universalistic public administration were critical to economic growth. This had an innovative test in Acemoglu, Johnson and Robinson (2001) which used settler mortality in European colonies as a measure of settler residence and by extension, the setting up of fair European style universalistic institutions or predatory institutions designed to exploit local natives. The places with low mortality and presumably good institutions had higher rates of growth. The proinstitution literature has recently become enormous. A review of the role of good governance can be found in Baland, Moene and Robinson (2010) and the role of property rights can be found in Besley and Ghatak (2010).

The new institutionalism is basically correct—particularly, when it emphasizes, as Acemoglu does, the importance of free rather than slave labor markets. However, growth has occurred in settings alongside modestly predatory state institutions and weak rule of law. Frank Dobbin has documented the surprisingly predatory relationship that existed in Victorian Britain between the government and railway companies where courts constantly slammed railroads with heavy financial penalties for a wide variety of unpredictable reasons. Colombia has had fairly high economic growth by Latin American standards despite a long history of violence and insecure property rights in its Southern half. Walder (1995) has argued that high rates of Chinese growth have coexisted with poor formal guarantees of property rights. *De facto* congruence of the interest of political elites with the economic growth of firms has provided for secure investment and middle-term planning—but with few of the Western legal defenses of the rights of companies or investors.

KEY QUESTIONS FOR FUTURE RESEARCH

Sociological research on the state and development has been excessively concerned with transformational development and needs to give more emphasis to palliative development. The focus on unequal terms of exchange has led sociologists to put a great deal of weight on peripheral nations obtaining access to the key technologies that would allow them to break the monopoly of core nations on strategic goods or to obtain strategic monopolies of their own. This has led to a concern with the strong states that could produce accelerated technological change. The transformational argument is a good argument. However, the processes of how the state creates favorable technological change are now well understood.

However, there is more to development than just getting strategic monopolies.

There is an overemphasis on creating strategic base sectors, and an underemphasis on increasing the size of the multiplier effect. The multiplier effect is the additional growth that occurs in the presence of a core industry from sales to local upstream suppliers and from sales of consumer goods and services to wage earners in the core industry (or in the local suppliers). Societies differ in the size of their multiplier effects. Latifundist societies have small multipliers because their wealthy elite buys imported luxuries while the starving poor can buy little at all; egalitarian societies have lower classes that buy goods and services and an elite whose restrained means induces them to buy locally.

Palliative development is any state strategy that increases employment in the short term. A great deal of palliative development involves increasing the multiplier effect. Palliative development can consist of increasing popular incomes to stimulate demand. It can consist of providing support to local firms that provide goods and services to the national population. It can stimulate demand by creating goods and services that are sufficiently attractive to create more local consumption than would have occurred otherwise. Construction of infrastructure, basic education, vocational education, entrepreneurial training for small business, microcredit, subsidized commercial space for small producers in downtown areas, organizing purchasing coops for small producers, providing technical assistance to small firms on engineering problems can all make a difference. These need more attention—particularly in sociology.

There are many other state and development issues to explore that go beyond the literature. One of the major functions of the state is to wage war. The relationship between war and growth is poorly understood. There is significant ambiguity about the relationship between education and growth. The state manages the debts of the nation. Do differences in compliance with creditor demands make a difference?

And just as cutting-edge research often took the form of older research that had been forgotten or minimized, new research may need retest and reestablish arguments that were made and justified years ago but then lost to recent debates. In current political discourse, the question of the state and development is now the question of whether growth could be increased by shrinking the state and cutting taxes. Although there is a sizable literature showing negligible growth effects from the reduction of taxes (Cohn, 2012), current fresh evidence on this point will need to be brought into the public arena.

Methodologically, what should be the new directions of research? One new direction might be the use of residuals-based methods to test for the effect of state policies net of market forces. One of the confounding factors in any discussion of the state and development is that it is necessary to identify how much economic growth came from government program X, and how much came from market-based growth that would have occurred anyway. The Krugman critique of the East Asian Development literature is that the developmentalist states would have grown quickly anyway because of the very favorable endowments of capital and education (Krugman, 1994). While Krugman is wrong about East Asia, his more general point that one needs to control for nonstate determinants of employment and growth before assessing the effect of state developmentalism is quite sound.

The best way to do this is to use a residuals-based method. One constructs and estimates a full-fledged model of growth or employment, narrowly using nongovernmental, purely market-based variables. One then actually runs the model and calculates the expected values for the dependent variable. Afterward, one subtracts the observed values to obtain residual employment or residual growth. Cases with high scores are locations with superior policies (or nonmarket factors) and those with low scores are locations with inferior policies (or nonmarket factors). One can then do fieldwork at these sites to explain the difference between high- and low-performing regions. Alternatively, one can add quantitative data on government programs and test for their effect knowing that the observed correlations are independent of market forces.

A few caveats are in order. This system works best on within-nation data rather than on cross-nation data. Multicountry datasets are affected by international differences in data collection conventions, which will show up in the residual effects. It is better to use data collected by one nation or agency that has internal consistency.

The control model also has to be concerned about spatial autocorrelation between cases. Such autocorrelation is not necessarily caused by Euclidean space and simple diffusion. A high-quality competitor in one region may steal market share from other firms in other regions. Cohn (2012) avoided this issue by picking industries with no significant cross-region trade, such as barber/beauty parlors. In an industry with national markets, competitive effects would need to be modeled explicitly.

Fieldwork can solve many of these problems. A simple model with no correction for spatial autocorrelation or competition can still be used to generate a "working" set of residuals that identify high- and low-performing cases. A fieldworker or ethnographer can then visit the concerned areas and assess on the ground whether differences in state policy, differences in competitive excellence, or some new-to-be-found regional factor explains what is occurring.

The best development work in sociology or economics will generally combine the strengths of econometric analysis with deep immersion into actual research settings, so that the numbers can be cross-checked with a detailed understanding of the full production context. Residuals methodologies provide an excellent way to structure such inquiries—and to guarantee that claims of the effectiveness of government programs are not giving false credit to places with favorable market-based endowments.

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