

Democratic Developmental State

Kidanemariam B. Hailu

DOC 11102

National Graduate Institute for Policy
Studies (GRIPS)

February 24, 2014

Principles of Neoliberalism

- **Price mechanism**: economic intervention by governments is the source of market failure and hence remove the state from all but minimal role. Allowing demand and supply to determine resource allocation is more reliable than to rely on politicians and bureaucrats (Friedman, 1962: Capitalism and Freedom).
- Role of the government should be limited to the protection of individual and property rights, enforcement of contracts, and safeguarding competition among economic actors. The neoliberal paradigm's ideal state is the **night watchman state** (Meles Zenawi, 2012).
- The market can always provide solutions to problems seemingly caused by the market.

Principles of Neoliberalism

The following are taken from Robert Wade's 2010 presentation on

AFTER THE CRISIS: INDUSTRIAL POLICY & DEVELOPMENTAL STATE

- “A nation that opens its economy and keeps government's role to a minimum invariably experiences more rapid economic growth and rising incomes.” (Robert Wade, 2010 from consensus at World Economic Forum, 2002, *New York Times*, 9 Feb, 2002, p.1).
- “Restrictions to market access for foreign investment should only apply to exceptional cases where national security is at stake”. (G8 communique, June 2007).
- “Free market theory, mathematical models and hostility to government regulation still reign in most economics departments at colleges and universities... The belief that people make rational decisions and the market automatically responds to them still prevails.... Graduate students who stray too far from the dominant theory and methods seriously reduce their chances of getting an academic job”. (Patricia Cohen, *New York Times*, 4 Mar 2009) [Also, a job in World Bank/IMF.]

Functions of State in Neoliberalism

- In a free society the state does not administer the affairs of men. It administers justice among men who conduct their own affairs.
- Ensure macroeconomic stability (price stability).
- Liberalize trade
- Protection of individual and property rights, enforcement of contracts, and safeguarding competition among economic actors.
- Improve business environment.
- Generally, in the words of Meles (2012), the state has a **night watchman** role in the economy.

Neoliberalism in Practice

- Great recession has led to widespread skepticism on the reliability of market economy.
- “Maldistribution of wealth, a few haves and so many have not's”.
- Much of the evidence runs against the neoliberal, and yet these evidences have tended to be ignored over past 30 years.
- All these and others have opened the way to a renewed thinking of the role of state in development.

Developmental state

- Meles Zenawi (former PM of Ethiopia) boldly challenged the neoliberal policy prescriptions and openly stated that Africa needs a paradigm shift away from the predatory state and neoliberal paradigm to a home-grown and more progressive one, i.e. the **democratic developmental state**.
- Prof. Akbar Noman of the Columbia University in his interview once said that “as far as I know, PM Meles Zenawi was the first head of government to criticize many of the **neoliberal prescriptions very early**. The Washington consensus-type policies are accountable for the lost quarter century of Africa. It is now widely accepted that there were lots of mistakes made in the kind of conditionality imposed in Africa in the 1980s in particular.”

Developmental state

Theoretical underpinnings of the developmental state argument (Zenawi, 2012):

- Two central tenets of the theory of the neoliberal paradigm to limit the state into a night watchman state are **rent-seeking** and **solely self-interested** behavior of citizens, politicians, public officials, and states.
 - **Rent creation**: promotes resource allocation and is growth-enhancing. Rent creation in a competitive market can be dissipated by the process.
 - **Rent-seeking**: process of transferring wealth through the aegis government and hence so long as the state limits its activity to its night watchman role, the economic process dominates and there will not be **rent-seeking (socially wasteful)**, only **rent creation (socially useful)**.

Developmental state

- Meles argues such a distinction between growth-enhancing rent creation and socially wasteful and state-created rent-seeking arises from the fact that the neoliberal paradigm views rent-seeking as **exogeneous** to the firm.
- However, there is no reason why state-created rent should be treated as external to the firm. The missing point in the neoliberal paradigm is that the possibility of the state-created rents to be **endogeneous** to the firm and related to its performance.
- Firms that perform in a certain manner would be given access to the rent and those that perform otherwise would have no such an access.

Developmental state

- In an environment where **imperfect competition** and **market failure prevail, endogenizing** rent-seeking activity and relating it to growth-enhancing performance of firms would result in an accelerated growth. Such rent-seeking would be similar to rent creation.
 - The rent would be dissipated overtime because the state would reduce (remove) the rent as its necessity for growth decreases.
 - This would result in efficient resource allocation as firms respond to higher profits and invest in areas where the rent has been created by the state aiming at accelerating growth.
 - There would be limited wasteful lobbying as the rent is provided based on performance.

Developmental state

- Meles says that this idea can be challenged by the neoliberal school on the ground that state actors make choices based on maximizing their **self-interest**, and hence would not create rent on the basis of performance.
- Mesles argues that why would the state with the **monopoly of coercion limit itself to be night watchman**.
 - The **solely self-interested** individuals in the state would use their monopoly of coercion to loot private property instead of protecting it, not to impartially enforce contracts but to steal the property of others.
 - As a **sole self-interest maximizer**, the state would do whatever it takes to maximize its benefit.
- Thus, a night watchman state based on the motivation of **maximizing self-interest can be prove its theoretical impossibility**.

Developmental state

- Logical absurdity of the self-interest behavior (rational choice theory).
- Difficult to have a stable and coherent state if its sole motivation is maximizing self-interest. State actors would act like **self-maximizing individuals and nothing would hold them together**. State actors would act like predator to loot and rob to increase their wealth.
- A well-behaved night watchman state can exist only if state actors are **not solely interest-maximizing**.
- Such a state to exist, state actors need to have **motives that keeps their self-interesting behavior in check**. This can happen if people are not only **self-interest maximizing**, such a behavior can be kept in check.

Democratic Developmental State

- For a developmental state to be successful in accelerating growth, it would have to build a high social capital that is vital for its endeavors, **Patronage and rent-seeking** would have to be stamped out. **These are the very same things that create the basis for democratic politics that is relatively free from patronage.**
- A successful developmental state would thus be very well placed to be both developmental and democratic.
- The problem, however, is that it is unlikely to find an environment where rent-seeking is removed and social capital is accumulated when developmental state is established.

Democratic developmental state

- Developmental state (DS) takes the responsibility to prepare the ground and accelerate development at the same time.
- It becomes inevitable that **patronage and rent-seeking to be the stumbling blocks to democracy at the initial stage** posing a trade off between democracy and development.
- **Policy continuity and sustained economic growth**: developmental policy is unlikely to transform a poor country into a developed one within the time frame of the typical election cycle.
- It is argued therefore that the DS will have to be **undemocratic in order to stay in power long enough to carry out successful development.**

Democratic developmental state

How does then the DS clean-up the mess of patronage and rent-seeking at its initial stage other than undemocratic means?

- We can think of the social-democratic coalitions in some Scandinavian countries and the center-right coalition in Post Second World War Japan, the so called dominant partly democracies which have played a developmental role and exercised democracy.
- Studies show stable long-term coalitions which stay in power for a long period but do so by democratic means can provide the needed continuity and stability of policy.

Democratic developmental state

- Examples: coalitions based on the labor movement and the middle classes in some Scandinavian countries, and coalitions between rural population and the right in Japan.
- The ruling coalitions in these countries have had regular, free, open and fair elections, and the basic political and human rights have been respected.
- They thus fully qualify as democratic regimes. But they have won elections repeatedly and have been in power for long-stretches. In the case of Japan the ruling coalition has been in power for almost 50 years.

Democratic developmental state

Can such a system be established in developing countries?

Candidates for such a coalition:

- **The private sector cannot be part of the coalition.**
 - The developmental state must be autonomous from the private sector so as to reward and punish the private sector actors depending on whether their activities are developmental or rent seeking.

Democratic developmental state

- Who then can be the candidate(s) for the coalition? Two alternatives:
 1. The rural population
 2. Wait until the creation of substantial business and middle class society
- However, the **second alternative seems unlikely** because such a society cannot be created in developing countries without the DS.

What remains is to form coalition with the rural population

- Any democratic state, developmental or otherwise, in a developing country will have to be agrarian at least in its initial stage.

Democratic developmental state

- A rural population based DS can use this to establish a stable coalition that rules democratically by fulfilling the interests of the farmers.
 - Agriculture as an engine of accelerated growth at least in the initial period of the process of development.
 - Equitable ownership of assets is a requirement for accelerated development of agriculture.
 - Commercialization of agriculture
 - support marketing and improvement in productivity have to be established.
 - Resource flow from agriculture should maintain the incentives for farmers to continue to increase production.

Democratic developmental state

Conclusion: Given that all of the above factors are fully consistent with the interests of the farmers, the rural population can therefore be the solid base for a stable developmental coalition in a developing country.

- Accelerated agricultural development also brings about changes in the social structure of the peasant to transform him/her into a force for democracy.
- With the votes of the peasants who constitute the **bulk of the coalition**, **with the democratic potentials of a socially transformed peasant**, the developmental coalition will have what it needs to **rule democratically and stamp out patronage and rent-seeking activities**.

Democratic developmental state

- A coalition based on the very sector, which has historically been the victim, rather than the beneficiary of **patronage and rent-seeking** activities will have all the will to stump it out.
- Benefiting from the accelerated growth, the urban middle classes and labor could also be members of such coalition.
- A coalition with a **vast majority of population that guarantees continuity through the democratic process** would be a solid base for a state that is both **democratic and developmental**.
 - Such a state forms the so-called **dominant party or dominant coalition democracy**.
 - Such a state based on a **solid and dominant coalition** of forces who have no stake in **patronage and rent-seeking** would be able to avoid and overcome **socially wasteful patronage and rent-seeking**.

Ethiopia's Democratic developmentalism

- Ethiopia is the second largest country in Africa with population of about 90 million, 85% of which live in rural areas.
- Govt understands that widespread market failure and rent-seeking behavior are the two most important stumbling blocks for development and installing democracy which can only be stamped out by a strong state intervention.
- As a result, the former PM of Ethiopia Meles Zenawi has always been uncomfortable with the neoliberal policy prescriptions of the World Bank and IMF and came up with a different alternative of democratic developmentalism (DD) in Ethiopia.

Ethiopia's DD

- “Ethiopia’s DD can be defined as a political regime in which a developmental party remains in power for a long time by consecutively winning multi-party elections, under which policies that punish rent seeking and encourage productive investment and technology absorption are implemented under strong state guidance.” (Kenichi Ohno, 2012)
- For instance: Strategy of combining carrots and sticks policy in the leather industry (Ohno, 2012)
 - As carrots: Leather Institute (training, technology, etc.), donor support, twinning with India, prioritized allocation of loans, matching with foreign firms, monthly gov’t-business meetings and monitoring, etc.
 - As sticks: a ban on raw material export and a high tax on semi-finished leather

Ethiopia's DD

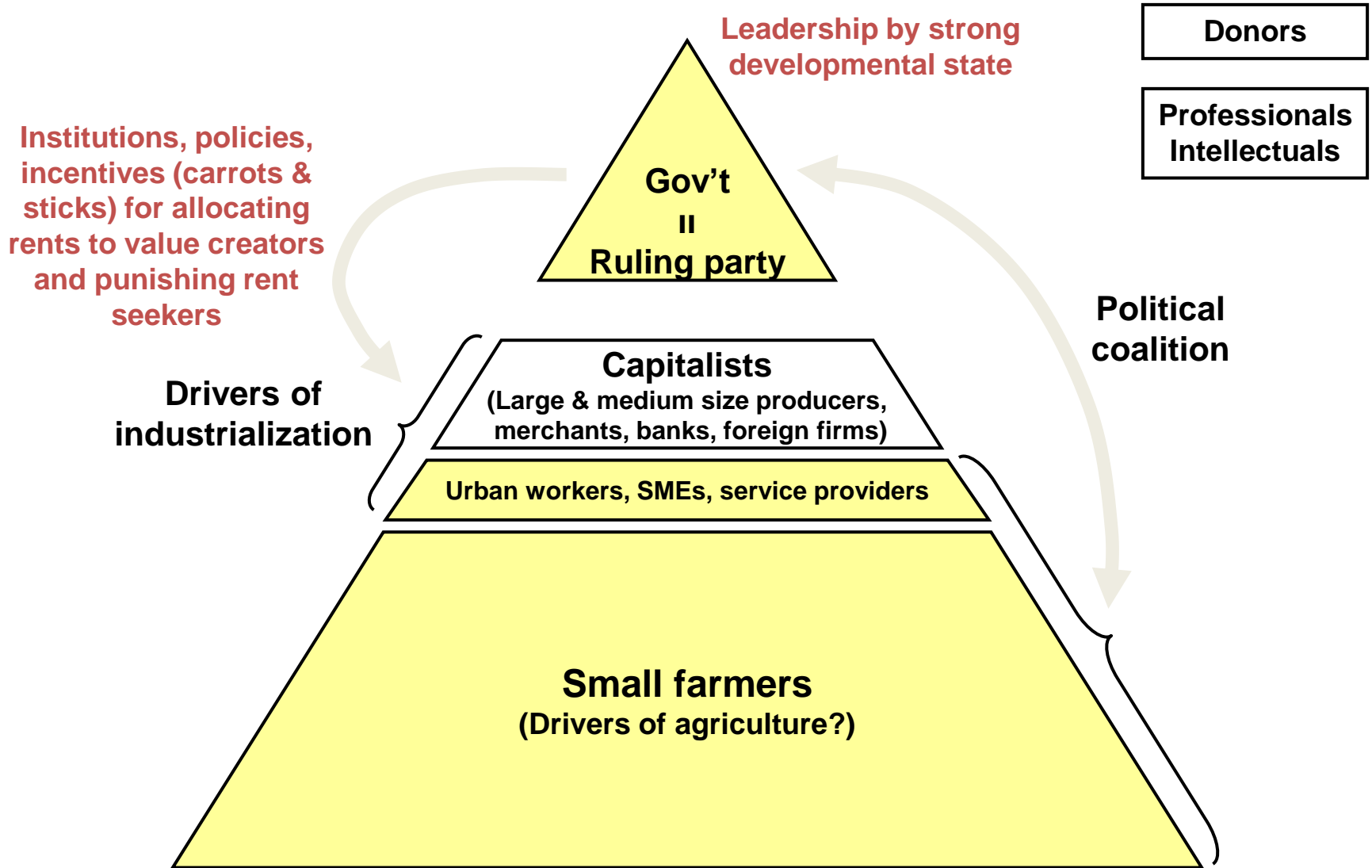
- With a DS thinking, the govt controls over the key segments of the economy (the commanding heights) such as banks, energy, transportation, telecommunication and other heavy industries.
- Govt investment in an area where the private sector does not find it attractive to invest.
- Since coming to power in 1991, the government has been pursuing agricultural development led industrialization (ADLI) as a development strategy.
 - Hence its strong political base is the small farmers which occupy about 85% of the population.

Ethiopia's DD

How does the government gain support from the farmers? Are the conditions for coalition satisfied?

- About 42% of GDP is allocated to the agricultural sector.
- Productive safety net programs.
- To increase agricultural production and productivity, a number of agricultural package programs have been introduced to the farmers.
- Natural resource conservation programs.
- Commercialization of agriculture.
- Equitable asset distribution (85% agrarian society).
- Recognition of model farmers: millionaire farmers have been created.
- Introduction of health extension programs.

Ethiopia's DD



Source: Prof. Kenichi Ohno's lecture

Ethiopia's DD

Impact of DD on the Economy:

According to African Economic outlook report 2012:

- Ethiopia is among the fastest growing non-oil producing economies in Africa with annual growth of about 11% since 2004.
- Growth was broad based with industry, services and agriculture growing by 15%, 12.5% and 9% respectively.
- Ethiopia is expected to achieve most of the Millennium Development Goals (MDG) targets.
- Ethiopia demonstrated strong progress in the health sector under the flagship of health extension programs.
- Income poverty declined from 38.7% in 2004/05 to 29.6% in 2010/11 owing to sustained growth in per capita incomes.

References:

- African Economic outlook report (2012):
<http://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/Ethiopia%20Full%20PDF%20Country%20Note.pdf>
- Ohno, K. (2013). Learning to industrialize: From given growth to policy-aided value creation. Routledge-GRIPS Development Forum Studies, Routledge, (Ch. 10).
- Zenawi, M. (2012). *States and market: the neoliberal limitations and the case for developmental state*. In Good Growth and Governance in Africa: Rethinking Development Strategies, edited by Akbar Noman, Kwesi Botchwey, Howard Stein and Joseph E. Stiglitz in Initiative for Policy Dialogue.
- Zenawi, M. African Development: Dead Ends and New Beginnings, preliminary draft (Ch. 7).
- Wade, R. (2009). Rethinking Industrial Policy for Low Income Countries. African Development Bank