

# The developmental state and its economic boundaries in South Africa.

*It is not the colour of the cat that matters  
as long as it can catch mice.*

(Deng Xiaoping on launching the Chinese economic reforms in 1978.)

- The concept of a *developmental state* lacks coherence. This is self-evidently true when it is viewed as a source or guiding idea for concrete proposals in economic policy. But its lack of coherence is equally true as a programme in the political sphere.
- At the highly abstract level of discussion that prevails for the *developmental state* one could say that either all states aim at development as an objective or that no states do.

- What distinguishes a *developmental* state from a state of some other kind? This is not specified sufficiently in policy discussion to be answerable.
- The phrase is then a slogan, a populist utterance with all the analytical deficiency that use entails.
- The intention of this paper is to ask *which* concrete economic policies, if any, can be plausibly associated with this label? [Not all of the following topic headings can be discussed in this presentation.]

- [1] We start below by posing the question: are there *minimum conditions* judged necessary by majority opinion amongst economists for a *well-functioning* economic system?  
Contentious but enlightening.
- [2] During the twentieth century the most significant economic experiment was *central planning* in the Soviet Union, followed in other economies of Eastern Europe and then China. It survives in smaller states today like Cuba & North Korea, or nominally planned ones like Vietnam & Laos.

- [3] In South Africa after WWII the existence of a Socialist Bloc influenced the content of the Freedom Charter (1955). Currently there are signs of nostalgia for what *then* was deemed a promising route to development. But the deficiencies of *planned allocation* began to emerge in the Soviet Union after post-war reconstruction. Recalling these provides a perspective on our National Planning Commission (2009) with its still ill-defined functions.

- [4] *What roles* are desirable and feasible for the *state* to play in the production process in mixed economies? This question has heightened pertinence where there are major divisions in income and wealth distribution within the population that demand attention.
- [5] What kinds of *organizations* in the public sector, like state-owned enterprises (SOEs), can potentially fulfil production, regulation and redistribution roles efficiently?

- [6] Does the history of *nationalization* yield judgements about its desirability in an economy like South Africa's? Or do the *trade-offs* between efficiency & equity goals after nationalization of private producers remain ambiguous one way or the other? Misappropriation of resource rents remains an outstanding problem.
- [7] What *governance* characteristics are possible & desirable in state-owned enterprises (SOEs), public-private partnerships and other organisations that serve the *public* purpose in the economy?

- **[1] Minimum conditions for a well-functioning economy.** That these may *not* add up to a consensus amongst economists is self-evident.
- *A decentralised information system* comprising an array of prices that reflect relative scarcities in the domestic economy & maintain a flexible coupling with world market prices.
- An exchange rate mechanism that expresses the *opportunity cost* of earning foreign exchange.



- *A limitation on the amount of information* required from government by all economic decision-takers.
- *Macro-economic stability* resting on independent monetary authorities' ability to set terms of credit & money supply growth; state budget in inter-temporal balance; taxation rates on income, wealth & activity that are stable, uniform, transparent; & a tax base legitimate in the eyes of tax-payers.

- An *autonomous private sector*, meaning enterprises are able to retain profits for investment purposes; have open access to capital markets; complete discretion in input & output decisions in the production process; pursue profit maximisation; unfettered access to material supplies & services in demand; a reasonable ceiling on the fraction of aggregate investment funds allocated through state budgets; financial discipline & autonomy for each enterprise.

- *Competition between enterprises* maintained by strict anti-monopoly regulation; by import competition that balances producer & consumer interests; an export strategy oriented & encouraged by deliberate policies.
- *Setting the economic boundaries of the state* that induce private credibility in long-term commitments by government; indirect or parametric policy methods, that is, a focus on constructed *signals* that economic agents use to make decisions, *not* responding to commands.

*Only now are they coming to the fair we are already leaving.*

(Russian proverb quoted against the Western left by dissidents during the 1970s.)

- Does the National Planning Commission come out of the same ideological hat as the concept of a *developmental state*? Although mentioned in the NPC Green Paper, we cannot know while the objectives & powers of the NPC are left so non-specific for the majority of decision-takers in the economy.
- Nevertheless a reminder of what most international observers *believe* about the history of national economic planning will be useful, especially so with the advantage of distance in time. Most planned economies disappeared by 1989, the year the Berlin Wall fell.

- An old distinction is useful here: *extensive development* consists of a growth process driven by increasing inputs of labour, capital, natural resources, energy and other. By contrast, *intensive development* is growth generated by increases in input productivity through technical progress. In the conventional methodology for measuring growth contributions, it is the Solow *residual output not* ascribable to measured input quantities. In the jargon, such growth is produced by *total (or multi-) factor productivity increases*.
- To put it simply, central planning proved able to produce the former but *not* the latter.

- East Germany is instructive. Long considered the most advanced of the planned economies, its growth was severely constrained in the 1970s & 1980s by rising balance-of-payments indebtedness to western economies. Highly dependent on imported technology, to produce exports wanted by producers & consumers in its western trading partners proved impossible. Its level of technical sophistication was inert and not reformable within the system. Political liberalisation and reunification saved its bacon, with *catch-up* policies and practices that still exist today.

- “I am for trade with the non-socialist economies, but not for dependence. We have come to a point where our room for maneuver has continually shrunk...Increasing foreign trade means we increasingly confront the principles of the world market. We have to be careful about that in a country like ours, which can only live by value-added production.” (Neumann, GDR Council of Ministers, 19 October 1989, quoted in Maier 1997: 59.)

*'It's a poor sort of memory that only works backwards' the Queen remarked. (Lewis Carroll, Through the Looking Glass.)*

- Concerning our own NPC, one observation is supportable even in the absence of detailed information about its tasks & functioning. If its projections into the future do *not* influence a major proportion of investment decisions in both the private & public sectors, then its impact on the economy's development will be *inconsequential*.
- So this is a crucial *test* of the NPC's capacity to construct or contribute towards development or possibly a developmental state, however that is conceived.



- State-owned enterprises (SOEs) have an unenviable history of being a *drag* and *not* a stimulus to growth in developing countries. Of course there were exceptions in the Asian high-performers, for example, in steel & ship-building in South Korea.
- We are certainly becoming more & more familiar with the symptoms of SOE failure in South Africa; for example, the widespread evidence of *soft budget constraints* entrenched across the spectrum of sectors. These are periodic bail-outs in the national budget (& managerial *expectations* of these & therefore inefficiency that endures).

- That they make up a common syndrome internationally is no comfort to us & particularly not to the disciples of a *developmental state*: see below.
- *It is widely believed that public enterprises tend to neglect their customers' wants; to allocate productive resources inefficiently and use them inefficiently; and to resist reform or closure when these are needed. Together the four beliefs compose what may be called a theory of public incompetence. (Stretton & Orchard 1994: 80)*

- Viewed historically & internationally what *roles* should we expect a state to perform in the national economy?
- By widespread agreement these are the production of *public goods*, *merit goods*, goods subject to *natural monopoly* conditions, and generally the *correction of market failures* (including regulation) where these are clearly evident. Then there are major *redistributive functions* via the tax-transfer mechanism. Whatever else it may mean, a developmental state has to accept the *minimal* responsibility for these actions.

- But it is helpful further to list our expectations of *what the state must do* at a more theoretical level. It must:
  - a) *Set and maintain priorities* among the many conflicting demands made upon the tiers of government so that they are not overwhelmed and bankrupted.
  - b) *Target resources* where they are most effective.
  - c) *Innovate* when old policies have failed.

- d) *Coordinate conflicting objectives* into a coherent whole for realisation.
- e) Be able & willing *to impose losses* on powerful groups. (Ostrom 1995)

If policy-makers insist on retaining the concept of a developmental state then this listing must become their *touchstone*. So far there is no evidence that these defining characteristics of a “well-tempered” state are entertained seriously in SA’s arena of policy discussion.

*Highbrow opinion is like a hunted hare; if you stand in the same place, or nearly the same place, it can be relied upon to come round to you in a circle.* (Denis Robertson, 1954)

- Two final observations convey the main intentions of this presentation.
- [1] Our future economic policies must concentrate on *catch-up*. This means acquiring the ability “to adopt and adapt better technologies to raise productivity. As an engine of growth, the potential of *technological learning* is huge – and largely untapped.” (Canuto & Giugale 2010: 3, italics added)

- *Since world knowledge expands continuously, economies that keep obstacles to innovation permanently lag the leading-edge technology, and thus the leaders' income per capita. In particular, when government-imposed regulations or development barriers deter the ongoing process of resource reallocation and firm creation and destruction, then technological adoption becomes sluggish and the economy fails to generate enough growth to close the developed-developing gap. Even though all economies end up fully adopting the new technologies, poor economies are always behind. (Bergoeing & Others 2010: 31)*

- [2] *Starting* policy identification with the concept of a developmental state is to put the rhetorical cart *before* the analytical horse.
- A more rational approach is to begin with the set of *problems* or obstacles we face in accelerating development. Then, using international & historical experience we identify a promising set of *policy actions* for intensive investigation. As a third step – if needed for political purposes – we might postulate the building of a *developmental state*. That is the logical order.
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