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The Power of the Visible Hand

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The Power of the Visible Hand

Abstract

This paper is an analysis of state capitalism as a vehicle for change in the global economic system. Specifically, it looks at how state capitalism can be seen as an emerging threat to the Bretton Woods system, as well as how it is becoming an increasingly popular model of development. From national champions, to the Belt and Road initiative, to a rising presence in emerging market economies, the state capitalism model is increasing in influence. Due to this rise in power of countries that practice state capitalism, the global structure of power can potentially be challenged, thus also altering the nature of relations between the global North and the global South.

Keywords

state capitalism, global economic system, power, global north, global south

Disciplines

Economics | Economic Theory | Macroeconomics

Comments

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The Power of the Visible Hand

After World War II, the United States was instrumental in shaping the current international political economic system, the Liberal International Economic Order (LIEO), through the creation of the Bretton Woods institutions. These institutions were built to advance America's vision of open-markets and rule of law (Rediker and Crebo-Rediker 2017). Due to its role in the creation of this system, the United States has also reaped many of its benefits, such as effective veto power in the International Monetary Fund (IMF), giving the United States a considerable degree of power in the LIEO. Through this power and influence, America has continuously preached the importance of market capitalism to the international system. This was especially seen in the 1980's, with the Latin American debt crisis and the push for neoliberalism by the IMF (Doran 2012, 52). America's influence in the international system has remained relatively unchallenged until recently, with the rise of the state capitalist country China gaining economic power and being seen as a potential threat. In addition to China, other state capitalist countries, such as the Asian Tigers – Hong Kong, South Korea, Singapore, and Taiwan, - have also gained a sizeable amount of economic power. Due to this rise in power of countries that practice state capitalism, the global structure of power can potentially be challenged, thus also altering the nature of relations between the global North and the global South.

Before looking at how state capitalism could affect the global structure of power, it is important to first define what state capitalism is. State capitalism refers to forms of capitalism that

feature high concentrations of state directed commercial enterprises, as well as varying degrees of state control over the financial sector (McNally 2013, 1). This allows countries to maximize control over economic and/or social policy. These state capitalist nations believe that “economic development has to be carefully managed, rather than being left to unpredictable and fickle market forces” (McNally 2012, 757). This economic system allows the state to be the principal actor in order to use the market for ultimately political gains.

Many countries are incentivized to practice state capitalism for developmental or political motivations, as well as to protect themselves from harmful effects of globalization. This form of capitalism is especially apparent in emerging market economies, such as Brazil, India, and South Africa, where the state takes an active role in managing economic development. State capitalism provides advantages such as the ability to “focus state funds on certain industries, provide capital to areas where the market will not go, and build up companies with economies of scale” (Kurlantzick 2016, 161). With many countries practicing state capitalism, there are also many flavors of this economic model. However, this paper will focus specifically on countries that have efficiently used state capitalism to become economically successful in global markets. State capitalism, just like free market capitalism, has both success stories and failures. For the purposes of this paper, it would be a null point to focus on when state capitalism is used inefficiently, as it solely the powerful state capitalist nations that are effectively challenging the global structure of power.

The success of modern state capitalism was first seen with the rise of the Asian Tigers. The combination of post-war aid, a booming global economy, and the creation of powerful bureaucracies allowed the Tigers to develop quickly. These countries were able to use state intervention and protectionism to jumpstart their economies. This allowed for high-growth rates,

which, in turn, has led to these countries becoming economic powerhouses (Whitley 2009, 14). China followed shortly after with economic reforms in 1978, focusing ambitiously on reforming state enterprise (McNally 2012, 753). State capitalism has more recently gained popularity after the onset of the 2008 recession, which crippled the economies of countries across the world. In an attempt to counter some of these economic effects, governments began to intervene with a heavier hand. While the global economy has since improved, many states continue to be heavily involved in their economies, “signaling a strategic rejection of free-market doctrine” (Bremmer 2009, 40). While in the past, rivalries existed over different political ideologies, now there is a new global competition among competing economic models. With this growing popularity of state capitalism, the international political economy is beginning to see a shift in winners and losers. Instead of just leaving resources up to market-forces, state capitalism allows governments to exert control over resources that otherwise would have been lost to the highest bidder (King 2010, 149).

With the rise in power of state capitalist nations, these countries could potentially leverage their influence to challenge the current global structure of power, specifically by creating alternatives to the Bretton Woods institutions. This is already beginning to happen with China’s creation of the Asian Infrastructure Investment Bank (AIIB) to finance infrastructure projects in the Asia-Pacific region. The AIIB currently has 70 members, many of which are America’s closest allies, including Britain, Australia, and Germany. This is noteworthy, as the membership of these powerful countries gives this institution credibility on the global stage. This brings unease to the United States, as it worries that China could use this investment bank to set the global economic agenda on its own terms, bypassing the World Bank (Perlez 2015). This is especially worrisome for America as it does not want to see the shrinking importance of an institution, the World Bank, that it has effective control over.

China has challenged the Bretton Woods institutions in other ways as well. It strongly backs the BRICS development bank in an attempt to foster alternatives to the World Bank, Asian Development Bank, and IMF. Along with this, China also encourages countries to support the initiative of using reserve currencies other than the dollar. Furthermore, central to China's foreign policy is the Shanghai Cooperation Organization, which links China to Central Asia and Russia. This is seen as a potential alternative to the Western-dominated United Nations (Kurlantzick 2016, 185). China has also begun to expand militarily, which can be seen through China's action in the South China Seas. However, while many United States officials agree that China is a dominant economic and diplomatic competitor, there is more disagreement over whether China is a significant strategic competitor (Seligman 2019). Nonetheless, these institutions and initiatives demonstrate China's willingness to shape its own system that could potentially diminish both the United States' and the LIEO's importance in the future.

The growth and success of state capitalism also has the potential to change the current relations between the global North and global South. Currently, China is focused on expanding its strategic and political influence over the global South, edging out the United States. While China's investments in Africa have held steady, the United States fund flows to Africa have decreased considerably. Unlike the United States, over the past 15 years China has increased its investments in Africa by over 520 percent (Holmes 2018). Now, China is focused on its Belt and Road Initiative, which is a development strategy focused on reshaping global trade. This will create a physical connection to Asia, Africa, and Europe, and could potentially increase China's global dominance. This initiative also has the potential to raise more than half the world population's living standards. With both geopolitical and economic motivations, the Belt and Road Initiative

has the potential to greatly change the global economic structure and further expand China's sphere of influence (Chatzky and McBride 2019).

Looking at Africa specifically, the AIIB, which provides finance for the Belt and Road Initiative, plays a large role. Through the AIIB, China has offered "no strings attached aid" to African countries (Li 2018). This unconditional funding is an alternative to more traditional aid sources, such as the IMF and World Bank, that tend to promote Western structural adjustment policies. Instead, these countries are able to make their own choices and determine what is good for them, for better or for worse. China's strategy of providing unconditional aid has profound geopolitical implications. China is able to grow its sphere of influence, as well as secure cheap resources to further fuel its own growth (Sun 2013). Due to China's success, as well as its presence in Africa, state capitalism has an obvious appeal to emerging market economies in Africa. United States Commerce Secretary Wilbur Ross recognizes that "by pouring money into Africa, China has seen an opportunity to both gain political influence and to reap future rewards" (Holmes 2018). Africa is the next frontier for state capitalism, and has the potential to lift many of these countries out of poverty.

State capitalism is a model attractive to developing countries. This is because it allows countries to protect infant industries in order to create economies of scale. For instance, in Singapore, the water and waste-water treatment industry was already dominated by massive Western companies in the early 1990's. However, the Singapore government stepped in and gave a Singaporean company, Hyflux, a couple of small projects to jumpstart the business. Despite initial backing, the government did not intend to protect Hyflux endlessly. Instead, it protected Hyflux until it was competitive on the global market (Kurlantzick 2016, 193). This model of protectionism is appealing as it allows emerging market economies to grow industries in order to

get a competitive advantage on the global markets. While protectionism was not successful in many Latin American countries, it has been in the Asia-Pacific region. This is because these countries make sure to combine protectionism with export-oriented strategies. The appeal of this economic strategy has led to its adoption by the Tiger Cub Economies, hoping to have the same economic success as the Tigers and other efficient state capitalist nations (Nehru 2011). The influence of state capitalism can be seen in other global South nations as well, such as in Cambodia. The West has lost its leverage over this government, as “the Cambodian prime minister increasingly has based his political and economic strategies on China, from his use of his political party to control big business to his use of the court system to dominate the opposition” (Kurlantzick 2016, 183).

Furthermore, the extent of power that state capitalist economies have in the global system continues to grow. For instance, it is “governments, not private shareholders, [that] already own the world’s largest oil companies and control three-quarters of the world’s energy reserves (Bremmer 2009, 40). The massive state capitalist power, China, has the second largest economy in the world and is predicted to eventually surpass the United States’ economy (Belvedere 2017). The presence of sovereign wealth funds, which are state-owned investment portfolios, continues to grow as well, and currently accounts for one-eighth of global investment (Bremmer 2009, 40). With state capitalism dominating the global market, developing countries have taken note and have adopted this economic model. Emerging markets have embraced state capitalism and have seen high-growth rates. When looking at the numbers, one can see that 70 percent of global growth will continue to come from emerging markets until 2030. Most state capitalists fall into this category of emerging markets, and are likely to experience this high growth (Kurlantzick 2016, 157).

The emergence of national champions has also given the global South a greater voice. Many state capitalist countries financially back companies that dominate the market. These national champions, in turn, help further the government's strategic aims. For instance, one of China's most prominent national champions is Huawei Technologies, a telecommunications equipment and consumer electronics manufacturer. Through central planning, China has taken the lead in backing its national champion in developing and deploying 5G networks. Neither the United States, nor other foreign manufactures such as Nokia or Samsung, have been able to keep up with Huawei Technologies in its scale of production (Roth 2019). With Huawei dominating the 5G industry and its strong ties to the Chinese government, there have also been rumors that this technology would allow a backdoor for the Chinese government to spy on people (Ghosh 2019). Regardless of whether this is true or not, this shows the potential for national champions to have a vast political impact. Due to this ability, national champions are also a way in which state capitalist nations are widening their spheres of influence.

The rise of state capitalism is not just an Asian phenomenon, as its success and influence can also be seen in the West. For instance, Brazil has also employed state capitalism and is now the eighth largest economy in terms of nominal GDP. Brazil has seen growing economic intervention, with the use of the state as a minority shareholder. Like Asian state capitalist nations, Brazil also has national champions, such as Embraer, which is the third largest producer of civil aircraft. While this company has now been privatized, the government gets a golden share that carries veto power (Hennart et al. 2017, 523). Brazil has also attempted to expand its sphere of influence, and "has become one of the largest aid donors in Central and South America" (Kurlantzick 2016, 152). Despite recent economic issues, Brazil is a great example of the success of state capitalism in the West.

Recently, under the Trump administration, American foreign policy has shifted to visibly recognizing the growing power of state capitalist economies. For instance, the United States has increasingly begun to use tariffs as a way to protect the nation against the effects of globalization. The United States is currently in a trade war with China, with retaliatory tariffs greatly impacting the economy (Donnan and Yadoo 2019). Furthermore, Trump has been artificially propping up the coal industry, using the state as a tool to overcome the market (Johnson 2019). These decisions signify that the United States is seeing a global shift in power, and is reacting, by interfering with the market, to maintain its own sphere of influence. Many of Trump's policies have shown a level of hypocrisy from the United States, where it is borrowing from the Chinese playbook to compete while simultaneously preaching the importance of a free-market economy (Johnson 2019). The United States is actively challenging China's growing importance and power through these market controls, feeling the pressures of state capitalism.

It is also worth noting that hegemonies, historically, are the ones that structure the international political economy system. Bretton Woods was created by the United States, which was a powerful hegemon coming out of World War II. Before Bretton Woods, Pax Britannica was put in place by Britain, which was the global hegemon at the time. With no hegemon lasting forever, a new economic order is traditionally shaped by a hegemon that has not only economic power, but also military power. For instance, the United States used its economic and military power to construct the LIEO (Ikenberry 1989, 376). China has already been established as an economic power, and is currently in the process of growing its military power as well. As discussed earlier, China's militarization of the South China Sea is one area where it is growing its military presence. China and Russia, both state capitalist nations, are also currently expanding their nuclear arsenals (Seligman 2019). While China has not yet made a serious challenge to the international

system, there is a growing belief that China cannot rise peacefully, and that it represents a clear and present threat to both American hegemony and the liberal order in general (McNally 2012, 742).

Along with the necessity of a powerful hegemon, the occurrence of a global crisis has historically played a large role in bringing about change to a global economic order. As Pax Britannica was greatly weakened due to two World Wars and the Great Depression, a new international political economy system, the LIEO, came out of these crises (Ikenberry 1989, 376). Many critics also question whether the effects of the 2008 recession will bring about deeper changes in the global structure. In order to manage this financial crisis, there were multilateral efforts to shift from the G-7 to a more inclusive G-20, that includes the BRICs – Brazil, Russia, India, and China – as well as other state capitalist nations. Furthermore, state capitalist nations have also gained greater power in the global economic order with the IMF altering voting shares to give the BRICs a greater voice (Oatley et al. 2013, 134). While institutions by nature are sticky and slow to change, a shift has already begun to occur, possibly signifying the growing importance of the global South, as well as an altering of the global economic system.

State capitalism has already been somewhat successful in changing the global economic system. It can claim some of the world's most powerful companies, from State Grid to Sinopec Group, due to strategic and efficient government intervention. While state capitalism's challenge to the LIEO has been limited thus far, it has the potential to greatly impact the global economic structure. From national champions, to the Belt and Road initiative, to a rising presence in emerging market economies, the state capitalism model is increasing in influence. Because state capitalism is fundamentally incompatible with a free-market globalized system, it is increasingly possible that there could be a major change in the economic order as state capitalist nations

continue to grow in both economic and political power (McNally 2012, 766). State capitalism has proven to be a viable economic model due to the success of the Asian Tigers, and offers an alternative to the Western free market system for the global South. As countries in the global South outnumber the global North, and with state capitalism becoming increasingly popular among the global South, it is likely that as state capitalism continues to grow, Western policy makers will see their power diluted in the international system.

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