How High Inequality Plus Neoliberal Governance Weakens Democracy

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Published online: 07 Dec 2014.

To cite this article: Robert Wade (2013) How High Inequality Plus Neoliberal Governance Weakens Democracy, Challenge, 56:6, 5-37

To link to this article: http://dx.doi.org/10.2753/0577-5132560601

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How High Inequality Plus Neoliberal Governance Weakens Democracy

Robert Wade

Few authors are better than this political scientist at covering a wide range of issues. Economists badly need to have their perspective broadened. The rise of neoliberal orthodoxy has left scars across the world. The author documents the damage and proposes a vigorous rejoinder from the West.

Mainstream politicians and mainstream economists in Anglophone countries have been very relaxed about people becoming “filthy rich,” as though a structure of income distribution with high concentration at the top has no society-wide costs. In the words of University of Chicago economics professor and Nobel Prize winner Robert Lucas, “[O]f the tendencies that are harmful to sound economics, the most seductive and . . . poisonous is to focus on ques-
tions of distribution." In the words of Willem Buiter, former professor of economics at the London School of Economics and currently chief economist of Citigroup, “Poverty bothers me. Inequality does not. I just don’t care.”

This article begins by describing the neoliberal thinking that supports a relaxed attitude to income inequality; next it describes why the discipline of economics has failed to provide a critical focus on income inequality; and then it summarizes evidence on the society-wide costs of inequality, especially the underemphasized political costs. The essay ends with some basic points for a center-left strategy of reform.

The central argument is that neoliberal thinking has helped to produce a rising degree of income concentration at the top both directly and indirectly through its contribution to the transformation of the Anglophone state into a “plutocratic” state. The plutocratic state has a structure of laws and policy settings that, net, channels income upward, even as some parts of the residual welfare state counter these tendencies by channeling income and services downward. The combination of high-inequality capitalism and a plutocratic state undermines the democratic political system.

**Neoliberalism**

People born in Western countries before the 1960s came to maturity during the postwar consensus around ideas of social planning and welfare policy (the University of Chicago Economics Department and a few others excepted). Governments followed full employment strategies, unions were strong, and governments believed that rising wages and job security were good for capitalism. Since the 1980s that consensus has been thoroughly displaced by another known as “neoliberalism,” especially in the Anglophone countries, and in international organizations that those states control, including the World Bank, the International Monetary Fund, and the Organization for Economic Cooperation and Development (OECD).

There are many strands of neoliberalism, but they share the core idea that “the (private) market” is the best mechanism for meeting...
human aspirations, and particularly better than “the state,” which is inefficient and a constraint on freedom, though necessary for certain limited purposes like national defense and law and order.

This is how neoliberalism is generally presented. But the presentation actually conceals what neoliberalism is about. “The market” is the polite way of referring to “the owners and managers of capital, especially financial capital.” To say that “the market” is the best mechanism for meeting human aspirations is to say that the state and public policy should reflect what the owners and managers of capital want—“should reflect” because their preferences for state institutions and policies will benefit the whole society more than the preferences of other categories (workers organized in trade unions, for example). This is the sentiment behind slogans such as “A rising tide lifts all boats,” and “What’s good for General Motors, and Goldman Sachs, is good for you and me.”

Alan Budd, special adviser at the UK Treasury in 1979–81, explained how the Thatcher government sought to create such a neoliberal structure in Britain by first creating mass unemployment, disguising the strategy as an anti-inflation strategy. Interviewed in 1991, he said,

The nightmare I sometimes have . . . is that there may have been people making the actual policy decisions, or people behind them, or people behind them, who never believed for a moment that this was the correct way to bring down inflation. They did, however, see that it would be a very, very good way to raise unemployment, and raising unemployment was an extremely desirable way of reducing the strength of the working classes. . . . What was engineered there in Marxist terms was a crisis of capitalism which re-created a reserve army of labour and has allowed the capitalists to make high profits ever since.

He said this a month after Tory chancellor Norman Lamont stated in Parliament (May 6, 1991), “Rising unemployment and the recession have been the price that we have had to pay to get inflation down. That price is well worth paying.” In fact, the rate of retail price inflation when Prime Minister Margaret Thatcher left office in November 1990 was identical to the rate when she took office in May 1979, at 9.2 percent, while the share of income accruing to the top few percentiles of the population had greatly increased.
The neoliberal microeconomic formula prescribes:

- low tax rates on high incomes and capital gains, so as to incentivize value creation—and hence generate economic growth and employment;
- low state benefits to people on low incomes, so as to encourage job search, training, and hard work;
- profit-seeking private firms or charities (not publicly owned agencies) for supplying goods and services, which translates into the imperative to privatize and outsource government services to the maximum extent possible;
- employment on short-term contracts, linked to performance targets and regular monitoring—because a highly “flexible” labor market is a mark of an economy’s strength (and not at all to be described as Marx’s “reserve army of labor”);
- employment on short-term, task-related contracts is especially important in the public sector, where the efficiency-inducing discipline of private profit-seeking competition is lacking;
- freedom for savings and loans, or building societies, to become consumed by national or multinational banks with no regional roots.

The paradox is that this agenda is particularly favored by political parties that describe themselves as “conservative” yet have little interest in conserving institutions that block opportunities for private profit-making. The reconciliation is effected by claiming that when applied comprehensively, neoliberalism produces more prosperous and more moral societies, composed of adults who are self-reliant, hard-working, and law-abiding citizens, and children who follow rules set by their strict fathers—or more so than societies with more state and less market.5

Contrary to the pattern in earlier bouts of hard times, elites in Western countries have even strengthened their commitment to neoliberalism since the global financial crisis of 2008 and subsequent long slump. Neoliberalism supports the macroeconomic agenda known as “expansionary austerity” or “fiscal consolidation” applied through
much of the Western world and now increasingly in developing countries, too (amplifying recessionary and unequalizing tendencies on a world scale). It rests on the claim that fiscal contraction at a time of recession (mainly through public spending cuts) will boost economic growth; or conversely, that above a certain threshold (generally believed to be around 90 percent), further increase in the ratio of public debt to the gross domestic product (GDP) will stunt growth. Policymakers and central bankers in the European Union (EU) have been particularly zealous about insisting that there is no alternative to public spending cuts and shrinking the state, however unpalatable that may be. “Growth is the key to getting out of the crisis, we all agree on that,” said Jens Weidmann, head of the Bundesbank, the German central bank, recently. “But renouncing budget consolidation will not bring us closer to that objective.”

A simple—and no doubt simplistic—way to see the fallacies of a lot of neoliberal economic thinking is to consider the situation where 100 dogs are ushered into a room in which 95 bones have been hidden. The macro (or Keynesian) problem is that there are not enough bones for the dogs; five must go without. But neoliberals reduce it to microeconomics and morality. Neoliberals of the compassionate conservative kind say: the problem is that the five dogs lack hunting skills, they must be sent to bone-hunting school, the state may even subsidize their education. Neoliberals of the normal conservative kind say: the five dogs are lazy, they must be spurred by withdrawing their income support (as in Norman Tebbit’s “Get on your bike and look for work”).

Meanwhile, the Western finance industry has effectively blocked government efforts to strengthen financial regulation (which could moderate neoliberalism). Banking is the most heavily subsidized industry in the world, by far, especially through the invisible subsidy of an implicit guarantee that if one of them collapses, the relevant taxpayers will save it—which allows the banks to take bigger financial risks than otherwise, grow bigger than otherwise, and become too big to fail or jail or manage effectively. The balance sheet of one British-based bank, Barclays, is bigger than Britain’s entire GDP. Andy Haldane of the Bank of England calculated the taxpayer subsidy to
the world’s largest banks at $70 billion every year between 2002 and 2007, the subsidy accounting for roughly half the average post-tax profits enjoyed by these banks over that period.

On top of the subsidies, governments authorize big tax advantages to the use of debt financing, as compared with equity financing, even as they complain that the economy is handicapped by too much debt and too little equity. The tax advantages of debt boost the demand for debt, and hence bank profits. And the tax advantages of debt mean that multinational companies like Google keep their profits in low-tax jurisdictions and borrow to pay out dividends rather than repatriate profits (on which they would pay tax), so squeezing Western tax bases.

Understandably the industry is doing everything it can to protect these built-in advantages, including all possible lobbying of governments against efforts to make the banks safer. Robert Rubin, the Democratic kingmaker on Wall Street and Treasury secretary under Bill Clinton, recently gave a remarkable defense of having some banks that are too big to fail. Asked by an interviewer whether he thought that “too big to fail” was a problem, Rubin replied,

No, don’t you see? Too big to fail isn’t a problem with the system. It is the system. You can’t be a competitive financial institution serving global corporations of scale without having a certain scale yourself. The bigger the multinationals get, the bigger financial institutions will have to get.8

In other words, the system requires that the biggest private banks are propped up regardless of their performance.

Separately from finance industry lobbying, governments have recently taken the initiative to scale down their financial regulatory efforts in the hope that this will encourage the banks to lend more to households, that households will increase consumption, and that consumption will again boost economic growth—and improve governments’ reelection prospects.

The upshot is that the effort at a Great Re-regulation in the wake of the Crash has become, instead, the Great Escape. The sprawling Dodd-Frank Wall Street Reform and Consumer Protection Act in the United
States has generated endless rule rewriting by regulators, leaving holes big enough to drive a coach and horses through. Almost three years into the euro crisis, the European Union is still in the early stages of figuring out how it might regulate banks across borders.

More favoritism to the banks comes via the monetary policy known as quantitative easing. It is presented to the public as a means of keeping interest rates low to stimulate business investment and the housing market. But it is at least as much about making banks appear more solvent or less insolvent. Low interest rates raise the price of debt instruments, and higher prices of debt instruments raise the value of banks’ balance sheets. In this way their collapse or radical restructuring is postponed in the hope that they can trade their way out of trouble, at least up to the next election. And while the policy has substantially failed in stimulating investment, it has worked to boost the stock market and the housing market—and thereby channel income up toward the top.

Neoliberal ideas have penetrated every nook and cranny of Western societies. In British universities they shape operations all the way from undergraduate recruitment to fees to the content of courses to research agendas to promotions. Not that this is all bad. For example, the periodic programs to evaluate the research output of every British academic and every academic department (known as the Research Assessment Exercise [RAE], though the current one, whose census date is December 31, 2013, is known as the Research Excellence Framework [REF]) have helped to break the old boy network dominated by Cambridge and Oxford and the leisurely academic lifestyle that could earlier be enjoyed. At the same time, the exercise produces a homogenization of thinking discipline by discipline, because the assessment panels tend to be readily captured by people representing the current orthodoxy, who judge others’ research by the standards of that orthodoxy.

Moreover, the intense performance-management justified by neoliberal ideas (and impelled by liability under employment law) produces, in universities, gross inefficiencies, such as a proliferation of managers and very time-consuming managerial demands on academics; an
erosion of intellectual collegiality; and a “bottom line” criterion for measuring the value of courses.

Far from wanting to conserve the BBC as a landmark of Britishness, ministers in the Conservative Party–led government, and the radical 2010 intake of Tory members of Parliament, want to reduce the BBC to the insignificance of U.S. public broadcasting, seeing it as an affront to the profit-seeking private sector media companies. The government has also been very helpful to private health firms wanting to divert tax-financed revenue flows away from that other landmark of Britishness, the British National Health Service (NHS). The government boosts a narrative of NHS failure (nurses too busy to care for their patients is one of the perennials) in order to justify privatization, including care for older people. And it downplays recurrent evidence of private firms making overly ambitious bids and underfulfilling contracts. The biggest company is Serco, whose modus operandi includes steep job cuts when it takes over from a local NHS trust, providing false data on its response to emergency calls, and even (according to a current investigation) charging the Ministry of Justice for tagging dead people.

The privatization or “opening up” of public services has fueled the process of casualization of employment. Local authorities respond to cuts in funding by driving through tighter tenders on outsourced contracts, whose contractors respond by offering employment on “zero hours,” such that employees are tied to the company with no guarantee of work. Agency working, temporary work, and enforced part-time working have mushroomed since 2008; nearly half of the jobs created have been temporary, as half a million permanent jobs have been lost. In early August 2013 the Conservative-Liberal Democratic coalition introduced a prohibitive £1,200 fee for anyone going to an employment tribunal to protect their legal rights. The obvious next step in “flexibility” is child labor.

Mainstream media content reinforces the neoliberal bias. Media ownership by profit-maximizing firms (as distinct from firms in the legal category of low-profit, or in cross-subsidizing trusts, as in the case of the Guardian) means that content is driven toward crime, sex,
celebrity, and scandal and toward political and economic commentary in line with the preferences of the owners and managers of capital. The result, in Britain, is that the readership of national newspapers is about 75 percent for “right-wing” papers and 25 percent for “not right-wing” (including the Financial Times). Scarcely an edition in the 75 percent leaves the presses without a hit against the BBC or the NHS. The British public is surrounded by a foghorn of right-wing opinion.

New Zealand has been an epicenter of neoliberal ideology since the reforms pushed through by the Labour government’s finance minister Roger Douglas after 1984. A story told by a former champion of neoliberal thinking in New Zealand, now senior policy adviser, illustrates how deeply neoliberalism has taken hold. He and colleagues were planning the privatization of air traffic control. One of his colleagues suggested that firms should tender or auction for each individual landing. At this point the penny dropped. “We suddenly realized it wasn’t very practical,” he said, without joking. Such was the zeitgeist when New Zealand was “a neoliberal model for the world,” and woe betide a New Zealand economist who argued against it.

New Zealand’s current labor law is among the weaker labor laws in OECD countries in terms of protecting and assisting workers, in line with neoliberal precepts. Most workers’ pay is now set unilaterally by the employer; only 9 percent of private sector workers are covered by a collective bargaining agreement, and about 25 percent of public sector workers. In the face of weak collective bargaining, labor productivity rose by almost 50 percent between 1989 and 2011 while the real average hourly wage rose just 14 percent—a gap that directly sluiced income up toward the top.

Yet the National Party-led government is now proposing to pass a law weakening labor protection and assistance still more. The draft law gives employers close to carte blanche to apply to the Employment Relations Authority for an order declaring an existing collective bargaining agreement at an end. And it creates a “no rights” period of sixty days thereafter when employers are free to pressure workers to sign individual agreements or to threaten to contract out the work to nonunion firms.

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This is just what neoliberal economics prescribes, for it sees unions as (a) groups that concentrate on getting a bigger share of the pie for themselves at the expense of making it grow over time, and (b) groups that cause inefficiency of resource allocation. So the right policy is to limit or remove the unions’ ability to exercise their harmful monopoly power—just what the new New Zealand labor law aims to do. This ignores—in line with the tendency of neoliberal economics to justify the preferences of the owners and managers of capital, and ignore structures of power—the effect of weakening unions on income distribution and the balance of power in the political system. Weaker unions allow business lobbying to face less counterweight, which indirectly tips income distribution even more toward the top.10

**Economics**

The discipline of economics might have provided an evidence-based check on the application of neoliberal precepts. However, throughout the West the great majority of university economists teach fairly conventional neoliberal economics.11 Indeed, they may not even teach much about real-world economies, as distinct from mathematical models. David Colander investigated the views of 231 graduate students at the seven top-rated U.S. economics departments and found that (in the early 2000s) only 9 percent thought that “a thorough knowledge of the economy” was “very important” for success. Broken down by year of study, he found that 15 percent of first- and second-year graduate students thought it “very important,” while less than 1 percent of fourth- and fifth-year students thought it very important—suggesting that the already low level of interest in real-world economies among the first- and second-year students had been thoroughly beaten out of them by the fourth and fifth years.12

Deep socialization into the mathematically elegant world view of economics leads economists to see themselves as members of an elite group, superior to other social scientists. As Durkheim’s and Pierre Bourdieu’s researches would lead us to expect,13 neoclassical economists are aware of their dominant position among economists and of
the status of economics as queen of the social sciences, and they are fearful of abandoning the “normal” conceptual and normative ideas of the paradigm even in response to easily observable events—like frequent financial crises and collapses of output around the world—lest they be alienated from the group. Robert Shiller, one of the few economists who spelled out the likelihood of a major crisis well in advance, admitted that, during his tenure on the advisory panel of the Federal Reserve Bank of New York from 1990 to 2004, he warned about the housing bubble “very gently and felt vulnerable expressing such quirky views. Deviating too far from consensus leaves one feeling potentially ostracized from the group, with the risk that one may be terminated.” Durkheim could not have put it better.

Young academics are often advised not to publish at all rather than publish in low-ranked journals like the Cambridge Journal of Economics or the Journal of Economic Issues or the Review of Keynesian Economics—low ranked because they publish papers that are “heterodox” and may not use formal theory.

The discipline’s epistemic certainty in the neoliberal core was expressed recently by one of the most highly respected academics in Britain, who has been central both to macroeconomic policy and control of entry to top economics journals. He exclaimed, “Keynes was a disaster. [Robert] Skidelsky [a latter-day Keynesian] should be locked up. [Paul] Krugman has lost all respect in the economics profession.”

The discipline accepted largely at face value the study by Carmen Reinhart and Kenneth Rogoff that discovered the 90 percent threshold for public debt relative to GDP, above which subsequent growth falls sharply. Policymakers and politicians wanting to slash social programs even in the face of mass unemployment seized on the finding as support for “expansionary austerity.” Soon after the paper was released, some critics pointed out that a negative correlation between debt and subsequent growth does not mean that high debt causes lower growth; low growth could cause high debt, as in Japan following its growth collapse in the early 1990s. But only when a graduate student at one of the few U.S. centers of “heterodox” economics tried to replicate
the results and discovered coding errors did the study receive wider critique. It is now clear that the 90 percent threshold is not robust and that the study fudges the important distinction between “failure to impose austerity amounting to a few percentage points of GDP might reduce GDP a decade from now by a fraction of a percent” and “failure to impose austerity is very likely to reduce future GDP by 10 percent,” which is how the austerity champions have interpreted it.17

A new IMF research paper finds that fiscal consolidation typically raises income inequality, raises long-term unemployment, and lowers the share of wage income; and that cuts in spending have bigger effects of these kinds than tax increases—yet most of the burden in Western countries has been placed on public spending cuts.18 Two things are striking about this paper, beyond its conclusions. First, it comes from the IMF—though it is a working paper from the IMF research department, which is quite separate from IMF operations (in its operations the IMF continues to push fiscal consolidation in most cases). Second, it is one of very few—in the economics literature as a whole—to examine the distributional effects of the standard Western policy prescription over the past several years. Few economists have been interested in distributional effects, reflecting the general lack of interest in income and wealth distribution across the mainstream economics profession.

The conviction of epistemic certainty reflected in the above quote from the distinguished British economist helps to explain why the discipline has resisted—until a small concession by the American Economic Association very recently—all efforts at an organized discussion about professional ethics. Economics has far more influence over people’s life chances than any other social science, up there with medicine and engineering. But while medicine and engineering give a great deal of attention to professional ethics, economics gives virtually none.19

Anyone who thinks economists’ allergy to ethics is not a serious problem should see the films Inside Job and The Flaw. The former includes the memorable exchange:

Charles Ferguson (director): “A medical researcher writes an article saying, ‘To treat this disease, you should prescribe this drug.’ Turns out
doctor makes 80 percent of personal income from the manufacturer of said drug. Doesn’t that bother you?”

John Campbell (chair of Harvard University’s Economics Department): “I think . . . It’s certainly important to disclose the, um . . . The, um . . . um . . . Well, I think that’s also a little different from the cases we’re talking about here, because, um . . . um . . .”

Income Inequality

Where neoliberal ideas reign, one finds that substantial increases in inequality do not provoke much political attention or citizen concern (beyond talk radio). The standard reflex is to point to Steve Jobs, J.K. Rowling, Steven Spielberg, David Beckham, and other contributors to the mass enhancement of life and say, “They obviously deserve their riches”—implying that the larger structure of income concentration carries no society-wide costs and that the government has no right to try to reduce income concentration at the top (except perhaps when an individual’s riches are “undeserved”).

Like other English-speaking countries, New Zealand has experienced a substantial rise in income inequality over the past three decades. In the early 1980s the top 10 percent of the population received about a fifth of disposable income. Ever since the mid-1990s, this segment’s share has been more like a quarter. In the three decades to 2012, the average income of the top 10 percent grew (inflation-adjusted) by 63 percent or 1.6 percent a year, while the average income of the bottom 90 percent grew by less than half that. Most households in the bottom 90 percent experienced stagnant and falling real incomes for the first two decades, until economic policy began to abandon the most extreme forms of neoliberalism. Top 10 percent real incomes increased in just about every year.

The top 1 percent did even better. Precise figures are not available, but estimates suggest that their share of total disposable income has risen from a low of slightly under 6 percent in 1980 to a bit under 9 percent today. But this includes only reported incomes, not realized capital gains or the large amount of income shifted into trusts.
(which pays lower taxes). Nor does it include the incomes of those living outside the country for part of the year who avoid having to pay any income tax at all (which does not prevent many of them from being actively involved in New Zealand politics). With these several kinds of income included, the share of the top 1 percent would be appreciably higher.

This degree of income concentration puts New Zealand well into the more unequal half of the OECD countries. By comparison, the share of the top 1 percent in Scandinavia is around 5–6 percent of national income and has remained flat since the 1980s (Norway was an upper exception for a few years in the 2000s). Other northwest European countries are similar. These countries demonstrate that it is possible to have a prosperous capitalism without income concentration as high as in New Zealand and other English-speaking countries.

But New Zealand income concentration remains well below the U.S. level, the United States having the most concentrated distribution among the OECD countries (apart from new developing-country members like Chile and Mexico). The share of the top 1 percent in U.S. national income (including capital gains) fell from a peak of around 23 percent in 1929 to a low of around 9 percent by the late 1970s, and then, with globalization, technical change, and Reagan, rose fast to regain the 1929 level by 2006, paving the way for the great crash of 2008. Another measure is the share of the increase in national income accruing to the top 1 percent. During the expansion of the Clinton years (1990s), the share was about 45 percent, during the expansion of the Bush years (2000s) about 65 percent, and in 2009–12 (Obama) it was 95 percent. Still another measure is the ratio of the remuneration of chief executives to that of the salary at the fiftieth percentile of total cash compensation for full-time employees at the same company or a subsidiary. Chief executives at Fortune 500 companies now earn on average 324 times the median. This is not a misprint.

British trends are similar to those in the United States, though not as extreme. Chief executives of the top 100 British companies now earn 185 times the median—making £4.8 million or $7.4 million a year with
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a mix of salary, bonuses, and long-term share plans. So British chief executives are impoverished compared to American counterparts. But they have gained very handsomely compared to 1979, when the executive pay ratio was only 15 times the average wage.25 And today they do very well compared to German counterparts; executive pay at the DAX 30 companies is “only” 90 times the average salary. Note that German CEOs are not relocating to New York or Dubai or retiring to play golf all day in protest of their relatively low pay.

Costs of Income Inequality: Economic

If higher-inequality countries (among the developed countries) were more prosperous, and if one could plausibly argue that their inequality was a necessary condition for their higher prosperity, then one could shrug off worries about inequality as merely “the politics of envy.”

At first glance the United States seems to suggest that inequality does go with prosperity: it is the most unequal of the developed countries and also about the most prosperous by GDP per person (though below about seven European countries in terms of the more relevant measure of prosperity, GDP per hour worked). But by many non-income measures of performance, the United States looks backward. It has the highest rates of infant and maternal mortality in the developed world, and life expectancy at birth and at sixty is among the lowest. The inequalities cascade down the generations, as rich families invest more in their children’s education and the state provides minimal preschool education; so the prosperity of American children is more dependent on the prosperity of their parents than that of children in most other developed countries.26 The United States and Britain have the lowest rates of intergenerational social mobility of the core OECD member states, which is ironic, given that they present themselves as free market economies with open opportunities, unlike the nanny states of old Europe.

Overall there is no evidence that more unequal countries are more prosperous, even by the standard income measures. New Zealand, one of the more unequal of the developed countries, ranked number
twenty-one in the OECD in terms of GDP per person (in 2005) and number twenty-two in terms of GDP per hour worked. This is hardly testimony to the economy-wide success of Roger Douglas’s neoliberalism (“Rogernomics”).

Most political attention to issues of inequality in the Anglo countries is actually about poverty and exclusion, such as the issue of the “living wage.” What many advocates miss is the intimate connection between problems at the bottom and income concentration at the top. They are opposite ends of the same thought. Increasing income concentration squeezes the share of income and tax payments of those lower down the income hierarchy. While the share of the top 1 percent was soaring in the United States over the 2000s, the disposable income of families in the middle of the distribution shrank 4 percent between 2000 and 2010, according to OECD figures. So to focus only on problems of the bottom (as in “Stop cutting resources for people with disabilities”) misses main causes of the problems at the bottom.27

Costs of Income Inequality: Social and Health

The best summary of the social and health costs of inequality is in The Spirit Level: Why More Equal Countries Almost Always Do Better, by Richard Wilkinson and Kate Pickett.28 Testifying to public concern about rising inequality, the book has sold about 250,000 copies in twenty-three languages since its publication in 2009.

The book pulls together a mass of evidence about the relationship between inequality on the one hand and, on the other, nine variables relating to social costs and health costs:

- level of trust;
- mental illness (including drug and alcohol addiction);
- life expectancy and infant mortality;
- obesity;
- children’s educational performance;
- teenage births;
- homicides;
imprisonment rates;

social mobility.

It draws on data from two samples: first, twenty-three developed countries; second, all fifty U.S. states. It measures income inequality by the average income of the top 20 percent over that of the bottom 20 percent when comparing countries, and the Gini coefficient when comparing U.S. states.

The bottom line is that the higher inequality entities (countries and U.S. states) have higher frequencies of social and health problems of the kind measured by the above nine variables. The correlation between inequality and frequency of social and health problems is much stronger than between average income (of countries, U.S. states) and the frequency of those problems; in particular, it is not the case that the frequency of the problems is higher in poorer entities and lower in richer entities. The United States and Norway have similar average incomes but are at almost opposite ends of the scale in terms of the index of social and health problems. The United States has the worst performance in the sample by a long way.

Wilkinson and Pickett’s argument has been criticized for relying largely on comparisons between countries and U.S. states at one point in time, providing little evidence on trends across time. True, but not much longitudinal evidence exists. Also, if the cross-sectional correlations are found to hold at different times and places, that is evidence that the relationship between inequality and social and health problems also holds over time in any one society. As the society becomes more unequal, performance on the above indicators deteriorates relative to what it would be if the society had not become more unequal. If you have photos of a man and a woman eating together in Wellington, London, and Rio, it is safe to assume that they are in a relationship.29

The best-known correlations are those between inequality and health outcomes, though these are actually weaker than those between inequality and the social indicators. One major study concludes,
Our meta-analysis of cohort studies including around 60 million participants [and including studies across time] found that people living in regions with high income inequality have an excess risk for premature mortality independent of their socioeconomic status, age and sex. . . . Although the size of the excess risk seems relatively “modest,” it has potentially important policy implications for population health as income inequality is an exposure that applies to society as a whole.30

Another major study concludes,

The death rate for U.S. adults 18 years and older continues declining . . . thanks to substantial socioeconomic development, medical advances and the public health movement. But increasing income inequality in the past three decades suppressed the overall improving health trend. We might have seen an even higher extent of improvement of health if income inequality had remained at a relatively low level.31

Then there is another debate about the likely causal pathways from levels of inequality to social and health outcomes. One is that higher income concentration is associated with a higher proportion of the population in relative poverty, and relative poverty is associated with poorer health and social outcomes. Wilkinson and Pickett go further, and argue that income inequality worsens health and social outcomes of not only the relatively poor but also the better off, through the mechanism of harmful effects of psychosocial stress. Some experts contest this argument.

Wilkinson and Pickett show a strong positive correlation between the level of income inequality and the density of the prison population: more unequal countries and U.S. states have more people in prison per 100,000 population. New Zealand’s figures are a lot worse than the average for countries with its level of inequality. The prison population rose from 91 per 100,000 in 1987 to 199 per 100,000 by 2011; and for the Maori it is now around 700 per 100,000. On a world scale the extremes are the United States, with around 740 per 100,000, and Iceland, with around 50. Scandinavia has around 60–70, Germany 90, the UK around 135, the highest in western Europe. So the New Zealand figure is far higher than the highest in western Europe. Yet crime rates have fallen significantly in the past twenty years.32
Costs of Income Inequality: Political

It is hardly surprising that elites in relatively unequal countries institute harsh penal regimes as a core defense of their superior position. Nor is it surprising that once the technology permits, they institute mass surveillance of their own populations’ contacts with one another and with foreigners, and classify information about the mass surveillance as top secret, and brand whistleblowers such as Edward Snowden “traitors.” In fact, the intelligence services of Western governments have long known full well about the U.S. and others’ programs. Snowden’s “crime” is that he revealed the programs to the public under surveillance, to whom governments are meant to be accountable. What is worrying is that large majorities of Western populations have passively accepted the steady rise in income concentration, the proliferating number of super-rich, the harsh penal regimes, the cuts to social services in the name of spurious economics like “you can’t cure a debt problem with more debt,” and now the passive acceptance of mass surveillance. Passive and fearful acceptance would not be surprising in a military dictatorship, but we in the West live in democracies.

The political costs of income concentration at the top include the erosion of the old understandings of the social compact binding states to citizens, as the resource flows based on these understandings are squeezed by the concentration of income at the top and by the ability of the rich to get their preferences translated into government policy when their preferences diverge from those of middle- and low-income voters (see below).

The upshot is a tendency for “establishment” elites to become “plutocratic” elites, the latter concerned mainly with using the levers of state power to create a structure of laws and markets that channels income and wealth upward and who rely on a combination of penal institutions, Murdoch-like media, and neoliberal economists to obtain
social compliance. As the income ladder stretches up, those high on the ladder tend to demonstrate a widening “money-empathy” gap, in the sense that their having far more money than everyone else itself tends to make them less empathetic, more prejudiced about categories of “other,” more selfish, more inclined to see others as either aids or obstacles to their own ambitions. This is one of the main conclusions from a body of recent research on the effects of social class by social psychologists such as Paul Piff at the University of California at Berkeley.34

The spirit of the money-empathy gap is caught in the recent statement by Paul Ryan, chair of the House Budget Committee and one of the most powerful politicians in the United States: Social programs “turn the safety net into a hammock that lulls able-bodied people to lives of dependency and complacency.”35

New Zealand Prime Minister John Key gave his own gloss. The National Business Review reported, “Prime Minister John Key today stood by his comment that some people needed to use food banks because they had made poor choices. . . . ‘Anyone on a benefit actually has a lifestyle choice. If one budgets properly, one can pay one’s bills,’ Mr Key said.”36

The money-empathy gap of the rich is all the more worrying in the light of recent research by Martin Gilens, among others, which shows that U.S. national politicians respond mainly to the wealthiest voters (not to the “median voter”). As Gilens summarizes,

When Americans with different income levels differ in their policy preferences, actual policy outcomes strongly reflect the preferences of the most affluent but bear virtually no relationship to the preferences of poor or middle-class Americans. The vast discrepancy . . . in government responsiveness to citizens with different income levels stands in sharp contrast to the ideal of political equality that Americans hold dear. . . . representational biases of this magnitude call into question the very democratic character of our society.37

Research by Benjamin Page and colleagues comes to much the same conclusion about the preferences of ordinary Americans and those of the very wealthy.38 The average American is somewhat worried about large budget deficits, unsurprisingly, given the barrage of media focus
on the deficit as the big problem. But the wealthy by a large margin regard the deficit as the most important problem, not unemployment or part-employment, and say that it must be cut by cutting welfare spending, not by raising taxes. The wealthy also say that the minimum wage should not be linked to the cost of living, contrary to the preferences of the majority. Actual policy reflects upper-class preferences. As Paul Krugman summarizes, “What the top 1 percent wants becomes what economic science says we must do.”

Another study starts from the staple of democratic theory, the argument that active participation in associations and civic organizations is crucial to a vibrant democracy. It examines the relationship between household income and civic participation (such as voting, visiting public officials, participating in school groups, civic and religious organizations) as the current recession developed from 2008 onward. It finds that the already low level of civic participation by low-income households (under $30,000 a year) fell; the higher level of participation by middle-income households also fell; and the level of participation of high-income households (over $100,000 a year), which was initially lower than that of middle-income households, was sustained. These findings help to illuminate the mechanisms behind the representational biases discovered by Gilens and Page et al.

The large representational biases found in the United States go with much evidence that the U.S. middle class, long the world’s embodiment of optimism and upward mobility, has become fearful of falling out of the middle class over the next few years. This pervasive middle-class fear feeds into the polarization of U.S. politics, including foreign policy.

In New Zealand, Finance Minister Bill English recently asserted, “Economic policy in NZ is not made by the top 1 percent for the top 1 percent.” Nicky Hager’s *The Hollow Men: A Study in the Politics of Deception*, provides graphic details about the role of a dozen or so super-rich donors to the National Party in the first half of the 2000s, which contradict the English hypothesis, but they are hardly conclusive. More comprehensive studies of the role of rich donors in New Zealand politics are lacking.
Conclusions

All through the period since 2008, the center-left in the Western world has remained on the defensive, unable to cohere around alternatives beyond more or less diluted neoliberalism. This is good news for the top 1 percent and especially the top 0.1 percent.

The center-left should take a leaf out of the strategy of the neoliberals. Milton Friedman summarized the right strategy at the time when they were on the political and economic margins and the consensus was for social planning and welfarism:

Only a crisis—actual or perceived—produces real change. When that crisis occurs, the actions that are taken depend on the ideas that are lying around. That, I believe, is our basic function: to develop alternatives to existing policies, to keep them alive and available until the politically impossible becomes the politically inevitable.42

Hence the neoliberal movement through the 1940s to the 1970s concentrated on quietly building think tanks and networks to develop the ideas and to train cadres while awaiting the crisis. When it came in the later 1970s the movement had the blueprints to put on the table and the cadres to implement them on behalf of the governments of Reagan, Thatcher, Lange/Douglas, and others. The subsequent great achievement of the movement has been to make the core neoliberal ideas seem as natural as gravity, to which there is no alternative, whether the troublesome public likes them or not. The wealthy like them very much, for they have directly helped to raise their share of national income and political power. And as the research by Gilens and Page et al. cited earlier suggests, the wealthy are able to shape public policy in line with their preferences and marginalize the preferences of middle- and low-income people when their preferences differ from those at the top, thanks to the financial imperatives of modern democracy and the ease with which the wealthy can exit or threaten to exit from a political domain they do not like.

Since the 1980s the non-neoliberal left, which has been at least as marginal as the neoliberals through the 1940s to the 1970s, has done little to build corresponding organizations and networks—one obvious reason being that non-neoliberal financing is always more
difficult. New Zealand has nothing close to a center-left think tank, and the few “heterodox” economists are scattered and disparate. The organizational weakness of the center-left, combined with media ownership by profit-maximizing firms (the national radio station being the valuable exception), produces the parlous state of New Zealand newspapers and television, which allows much neoliberal policy to go unchallenged except at the edges.

The center-left should be able to capitalize on the fact that high-income concentration probably means that a majority of the population experience stagnant or falling incomes and a squeeze on tax-financed social spending.

Here are several points that should go into a center-left strategy.

All Taxation and Public Spending Should Be Scrutinized for Distribution Effects

One of the most important steps is to “normalize” the evaluation of all tax and public spending in terms of effects on the distribution of income and wealth. Too often many of these measures escape distributional scrutiny by being presented as good for “the economy.” The implicit government guarantee that banks above a certain size will not be allowed to fail, and the tax advantages given to debt financing, are examples. And the most spectacular recent case of hidden income concentration effects is the combination of the fiscal policy of “expansionary austerity” or “fiscal consolidation” across the Western world since 2008, and (in some countries, notably the United States and the UK) the monetary policy of “quantitative easing,” both of which are discussed above.

“Predistribution” Is Even More Important Than Redistribution

Those concerned to rein in income concentration must pay attention to matters well beyond tax and spending—the latter having been the familiar battleground for left-right fights. The key distinction is between predistribution of market incomes and redistribution of market incomes
by the state through taxation and public spending. The main determinant of inequality of “take home” income (after tax and spend) is not the magnitude of redistribution but the inequality of market incomes (before tax and spend), so to focus on lowering the concentration of income by tax and spending measures is to miss more than half the picture. One has to examine the whole array of state laws, regulations, and policies for their effects on the distribution of market income, before taxes, particularly to show how, in high-inequality developed countries, many parts of the array (including corporate governance law, trade union law, patent law, monetary policy, exchange rate policy, and more) have the effect of sluicing market incomes upward. If corporate governance law says, for example, that CEOs appoint the boards of directors and that the directors decide the remuneration of CEOs, no prize for guessing what happens to CEO remuneration. Of course, we are told that top pay rises because firms compete globally for the best talent—and therefore whatever is paid is justified. In fact, only 1 percent of the chief executives of Fortune Global 500 companies were poached from another company in a foreign country.

It is largely through predistribution measures that the plutocratic elites of the United States, the UK, and some other Western states have quietly built up a “conservative nanny state,” with income concentration as one of its expressions. The center-left should press hard to reveal the mechanisms by which the conservative nanny state works.

**Stop Talking Down the State**

A further major change to be promoted by the center-left begins by challenging the standard neoliberal opposition between “state and market,” based on the idea that “the market” is natural and the state is “artificial,” which goes with a constant talking down of the state and talking up of the private sector, as though the latter is a caged lion just waiting to spring free from state regulations. For all its faults, the democratic state has an advantage over the private sector in that state actions do have to be justified in terms of societal values, as the actions of private firms do not, and the leaders of the state can be re-
How High Inequality Weakens Democracy

placed (and their remuneration set) as a result of citizen preferences expressed in public forums—which is also not the case for leaders of firms. Moreover, the state can exercise comprehensive foresight about the economy’s future growth in a way that private firms typically do not. These and other points are the basis for formulating a vision of more complementary roles of state and markets in a capitalist society.

Stop talking down the state means that the question of privatization or outsourcing is to be answered pragmatically, not by an assumption that the private sector is always more productive than the public sector (or vice versa). The pragmatic answer is that a private company will probably outperform a public agency when the goals are clear, when achieving them does not undermine other socially desirable outcomes, and when rewards to managers and employees can be aligned with the goals. When the goals are complex and diffuse, the profit motive may make them more difficult to achieve, and privatization is probably not the solution.44

Industry Policy Can Help Achieve a “High Productivity–High Wage” Growth Path

The idea of a complementary relationship between state and market—and not just a “framework-providing” state—is especially important in the case of industry policy, or economic development policy more broadly. In neoliberal economics the very phrase “industrial policy” is toxic and is automatically equated with “picking winners,” to be rejected with “the government cannot pick winners but can pick losers.”45 The center-left has been far too willing to conduct the debate on the terrain favored by the right—the public sector—and ignore how to reform the private sector.

That the United States remains by far the most innovative economy in the world is due in no small part to an active industrial policy—but one kept below the radar to escape political censure.46 The Defense Advanced Research Projects Agency (DARPA), the National Institutes of Health, and several other federal agencies have been key to a swathe
of U.S. breakthroughs in “general purpose technologies.” To take only the information and communications revolution: The U.S. National Science Foundation funded the algorithm that drove Google’s search engine. Early funding for Apple came from the U.S. government’s Small Business Innovation Research Program. Moreover, in the words of Mariana Mazzucato, “All the technologies which make the iPhone ‘smart’ are also state-funded . . . the internet, wireless networks, the global positioning system, microelectronics, touchscreen displays and the latest voice-activated SIRI personal assistant.”

The reason the state role has been seminal is beyond the ken of neoliberal economics: it is that private companies will not bear the uncertainties, time spans, and costs associated with fundamental innovation; and the more competitive, finance-driven the economy, the less its firms will bear these risks. (In another blow to neoliberal economics, the great breakthrough discoveries from the private sector—from Bell Laboratories, for one—came from monopolists, with money to spare.) The U.S. state has not only borne the costs of many breakthrough innovations; it has acted as an entrepreneur, providing directional thrust to entrepreneurship in the private sector. The problem is that the neoliberal conviction about the sanctity of private profit then kicks in, with the result that the public sector hands over innovations to the private sector for almost no return, while the private sector appropriates the credit and the profit—so the neoliberal dictum “The government cannot pick winners but can pick losers” prevails, and state budgets (including for research) continue to be squeezed. The solution is to implement “taxpayer warrants,” such that the public sector earns royalties on innovations (in information technology, pharmaceuticals, etc.) from which the private sector profits. This is all the more imperative if societal challenges like climate change, renewable energy, healthy aging, and food security are to be met.

Germany, too, has long practiced active and successful industrial policy, also kept unadvertised; though in the past decade and more, its government has limited the role of the state, and the economy has failed to remain at the forefront of today’s new technologies. Taiwan has long practiced both a “big scale” and centrally coordinated indus-
trial policy and also a small-scale nudging kind of “industrial extension” policy carried out by the Industrial Development Bureau.\textsuperscript{50} Active industrial policy is all the more important to promote economic diversification in countries like New Zealand reliant on commodity exports to China, as China slows down; and all the more important for everyone as climate change and population aging speed up. Diversification and innovation left to the “free market” will be far too slow.\textsuperscript{51} That the economics profession in developed countries operates within the ideological precepts of neoliberal economics and largely ignores the non-neoliberal programs of industrial policy is testimony to the epistemic certainty of the neoliberal core.

Of course, in a small open economy like New Zealand’s, the constraints on an entrepreneurial role of the state are tighter than in a much larger and less open economy like the United States. The owners and managers of large businesses can always threaten to exit, and exporters can put all their lobbying efforts into keeping labor costs as low as possible, ignoring the Keynesian mechanism of higher wages translating into higher demand. But it would be possible to counter these tendencies by a government talking up its entrepreneurial role in assisting firms to shift to a “high productivity–high wage” path, which entails more tripartite collaboration around the vision of a national project in forums like the old Planning Council, and more public effort at building up New Zealand–based supply chains, along the lines of what Taiwan’s Industrial Development Bureau has done ever since the 1950s.\textsuperscript{52}

\textbf{Rebalance Power in the Labor Market}

Then there is a whole set of issues around the representational biases in democratic politics reported earlier and the effects of the hollowing out of middle classes on civic participation. One issue has to do with the “minimum wage.” Increases in the minimum wage tend to raise median wages, and increases in both can be expected to raise participation in democratic society. A plutocratic elite is likely to fear such an increase in participation and to resist wage increases not
only for profit reasons but also for political reasons. But everyone who values a vibrant democracy should support efforts to rebalance power in the labor market, including through higher minimum and living wages and an expansion in the legitimate role of trade unions (drawing inspiration from their role in Germany and Scandinavia).

**Political Financing**

A second issue under the heading of correcting representational biases is political party financing. As long as political parties and candidates depend heavily on a relatively small number of donors and lenders—which goes up as income concentration rises—their policies and commitments will incline toward the wealthy when the preferences of the wealthy differ from those of the rest. It is as simple as that. But political party financing is the “third rail” of politics, which none of the big players wish to touch. The UK Committee on Standards in Public Life published “Political Party Finance: Ending the Big Donor Culture” in November 2011. It identified three main routes for reform: (1) Restrict the amount any individual or organization (companies, trade unions) can give or loan; (2) limit party and candidate (campaign) spending; (3) provide public funding. Although long and careful, and launched with fanfare, the report died on the day of publication. Nothing more has been heard of it, to audible relief in the corridors of Westminster.

**Insist That Banks Maintaining a High Minimum Capital-Adequacy Ratio**

For all the complexities of stabilizing the financial system, one measure stands out as a potentially very powerful and commanding broad agreement across the political spectrum. Given that banks typically borrow too much, and the present regulations are too confusing, regulators should require the use of a simple number to indicate the extent to which a bank’s owners could bear most losses without requiring a bailout. If a high ratio (15 percent or more) means that banks are smaller and lend less, that is the price of a more stable system.
This short discussion has suggested several agenda items for a center-left strategy. The starting point has to be the evidence that capitalism in much of the West has been working at cross-purposes to democracy. Yet the confluence of forces making for a conservative nanny state and rising income concentration at the top—and squeeze lower down—seems to be locked in, through mechanisms as varied as political party and candidate funding, tax advantages attached to debt finance, dependence of banks on proprietary trading for a major share of profits (almost a guarantee of imprudent banking), and the hegemony of neoliberal economics, with its nonchalance about income concentration and its antipathy to unions. The center-left has its work cut out, but it can draw courage from Friedman’s summary of the strategy for the neoliberal movement at a time when it was on the fringes, and from the obvious electoral opportunities presented by the fact that large majorities find their standard of living stagnant or declining as income concentration rises. It must shift the debate away from “you (conservatives) want free markets and we want more redistribution through the state to help the disadvantaged,” partly because this makes it easy for conservatives to play on middle-class anxieties using the slogan “We stand for freedom, hard work, and innovation, while you stand for taxing the successful and giving handouts to losers.” Rather, it should say: “You want to rig markets in favor of the rich, while we stand for making markets work more fairly for everyone.” Hopefully the center-left will draw in some far-sighted wealthy people and organizations equivalent to John Maynard Keynes, who while making fistfuls of money for himself and Kings College, Cambridge, also worked seriously on solving the problems of mankind.

Notes


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7. Tebbit became famous (or notorious) for this remark, but it is a statement of what he implied, rather than what he said, while a minister in the government of Prime Minister Margaret Thatcher in 1981.


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21. One should be wary of “inflation-adjusted.” Statistician John Williams (shadowstats.com) reports that recent U.S. real GDP growth has been artificially boosted by an understated measure of inflation. If nominal GDP is deflated with the previous official methodology, U.S. GDP growth has actually been negative between 2007 and today. See also Paul Craig Roberts, The Failure of Laissez Faire Capitalism (Atlanta, GA: Clarity Press, 2013).


24. The top pay/average pay figures come from the UK High Pay Center. The 1979 ratio is based on five major companies.

25. See http://elsa.berkeley.edu/~saez/TabFig2012prel.xls.


29. Thanks to Richard Wilkinson for this metaphor, August 2, 2013.


31. Hui Zheng, “Do People Die from Income Inequality of a Decade Ago?” Social Science and Medicine 75 (July 2012): 44.

32. See Kim Workman and Tracey McIntosh, “Crime, Imprisonment and Poverty,” in Rashbrooke, Inequality and New Zealand.

33. I asked several prominent New Zealanders whether the Snowden revelations

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about the U.S. Justice Department scooping up data on telephone calls and Internet communications had raised alarm bells in New Zealand, given that New Zealand and its Government Communications Security Bureau (GCSB) is a member of the five-country sharing entity at the core of Western intelligence (with the United States, the UK, Canada, and Australia). They seemed to know virtually nothing about it and evidenced no concern. My question stems from my and many others’ concern that the USA Patriot Act Section 215 allows the FBI and the National Security Agency to obtain court orders for surveillance—from the highly secret Foreign Intelligence Surveillance Court—on grounds that it might produce evidence “relevant” to an investigation, and not just a present investigation but a possible future one; and they need not demonstrate probable connection to a crime or terrorism. The court can approve surveillance of whole categories of people or organizations, not just specific people. One of the architects of the Patriot Act, Representative James Sensenbrenner, has said, “Congress intended [with the Patriot Act] to allow the intelligence communities to access targeted information for specific investigations. How can every call that every American makes or receives be relevant to a specific investigation?” (quoted in Jennifer Stisa Granick and Christopher Jon Sprigman, “The Criminal N.S.A.,” International Herald Tribune, June 29–30, 2013). But the Obama administration is at full steam ahead in its mass surveillance activities, seemingly marginalizing the Fourth Amendment to the Constitution, which declares: “The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures shall not be violated.” Presumably New Zealand’s GCSB is cooperating.


41. English made the assertion in an interview on TVNZ’s Q&A on Sunday, July 14, 2013, in response to my summary statement that economic policy in high-inequality countries like the United States, the UK, and New Zealand is being made by the top 1 percent for the top 1 percent. (I should have made more of a distinction between New Zealand and the others, for reasons given earlier.) The irony is that, according to Nicky Hager (The Hollow Men: A Study in the Politics of Deception [Nelson, NZ: Craig Potton, 2006], especially p. 213), English was replaced as National Party leader in 2003 by Don Brash because English advocated too centrist policies for the dozen or so Big Donors on whom the National Party depended, while Brash promised the party caucus that the
donations would flow with him as leader and future prime minister—without spelling out the hard-right policies wanted by the money men. Hager’s book describes in detail the deception of the electorate that went on in the run-up to the 2005 election to keep the hard-right policies out of sight. So English himself had directly suffered from the influence of Big Donors on National Party policy. Hager observes, “What is significant about National’s main donors is not so much their wealth (and they are very wealthy) but their political beliefs. These are not well-heeled businesspeople who happen to lean a bit to the right. This small and distinct group comes mostly from the radical right of New Zealand politics and business” (ibid., 223).

47. Mariana Mazzucato, The Entrepreneurial State (London: Anthem, 2013); Martin Wolf, “The State Is the Real Engine of Innovation,” Financial Times, August 5, 2013, 10. To describe the component technologies of the iPhone as entirely state-funded is an exaggeration.
48. This statement now needs qualification, as billionaire entrepreneurs like Jeff Bezos of Amazon and Sergey Brin, cofounder of Google, are pushing for the next big technological breakthroughs in space exploration, robotics, advanced materials, and new forms of ground transportation.
50. See Wade, Governing the Market, especially chaps. 7 and 9.
Social Democracy in the Global Periphery

Social Democracy in the Global Periphery focuses on social-democratic regimes in the developing world that have, to varying degrees, reconciled the needs of achieving growth through globalized markets with extensions of political, social, and economic rights. The authors show that opportunities exist to achieve significant social progress, despite a global economic order that favors core industrial countries. Their findings derive from a comparative analysis of four exemplary cases: Kerala (India), Costa Rica, Mauritius, and Chile (since 1990). Though unusual, the social and political conditions from which these developing-world social democracies arose are not unique; indeed, pragmatic and proactive social-democratic movements helped create these favorable conditions. The four exemplars have preserved or even improved their social achievements since neoliberalism emerged hegemonic in the 1980s. This demonstrates that certain social-democratic policies and practices – guided by a democratic developmental state – can enhance a national economy’s global competitiveness.

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Social Democracy in the Global Periphery

Origins, Challenges, Prospects

Richard Sandbrook, Marc Edelman, Patrick Heller, and Judith Teichman
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This book, which emerged from a movable seminar, has received generous intellectual and financial support in the course of its travels. Our first two-day symposium at the University of Toronto’s Munk Centre for International Studies, in the winter of 2003, established a pattern: a public forum followed by a private all-day session involving the four authors. We would like to thank Professor Louis Pauly, the director of Toronto’s Centre for International Studies, for his consistent financial and personal support for this project.

Richard Sandbrook, a University of Toronto political scientist who has focused his research largely on the political economy of Africa and globalization, had enticed the other three authors to join this project during the summer of 2002. His aim, as he explains it, was to enlist the cooperation of talented area specialists with an interest in distributional issues and diverse disciplinary backgrounds. Judith Teichman is a political scientist at the University of Toronto who has long studied the politics of neoliberal reform in Chile and elsewhere in Latin America. Patrick Heller, a sociologist at Brown University, has written a well-received book on Kerala’s political economy of development. And Marc Edelman of Hunter College, City University of New York, has pursued extensive and broad-based anthropological studies of Costa Rica, especially concerning the role of peasants in globalization. Sandbrook’s three co-authors would like to acknowledge his leadership role, not only in inspiring this project but also in so effectively pushing it toward completion.

Although this team was well prepared to write an interdisciplinary and transcontinental comparative study, we realized that the process might not be easy. Would we get along? The first movable seminar in Toronto removed that concern; the authors could, indeed, cooperate and even gracefully concede points in heated debates. Other symposia followed, as the authors conducted further field research and resolved methodological and analytical disagreements. Our second two-day symposium, in November 2003 at the Watson Center for International Studies at Brown University, allowed us to gain valuable feedback from Brown’s renowned
comparativist scholars. Professor Barbara Stallings not only generously provided the funding for this meeting through her Political Economy of Development program, but also contributed valuable ideas in our public seminar. Further symposia took place in Toronto in March 2004, Hunter College of the City University of New York in July 2004, and again at the Munk Centre, University of Toronto, in January 2005. Then the writing of the final draft proceeded in earnest.

The authors have benefited from research grants that have advanced this project. Judith Teichman and Richard Sandbrook gratefully acknowledge their individual research grants from the Social Sciences and Humanities Research Council of Canada. Marc Edelman has received crucial support from Grant #65512-00 34, PSC-CUNY Research Awards Program.

But the book would not have achieved whatever merit it has without the intellectual support and frank criticism of so many friends and colleagues, many of whom participated in our various symposia. A mere listing of names cannot possibly convey the extent of our gratitude and warm regards toward the persons mentioned. Dietrich Rueschemeyer at Brown University and Atul Kohli at Princeton were particularly helpful, the former for ongoing inspiration and feedback, and the latter for organizing a workshop at Princeton to discuss this project and for commenting on selected chapters. Others who have helpfully located relevant sources, shared their views on the issues, or commented on various chapters—and whom we hereby absolve of any responsibility—include Oscar Altimir, Albert Berry, Michael Blim, Sheila Bunwaree, Katrina Burgess, Melani Cammett, Linda Cook, Guillermo Garcia-Huidobro, Lesley Gill, Angelique Haugerud, Paget Henry, José Itzigsohn, Don Kalb, Matthew Lange, James Mahoney, Iván Molina, Stephen Palmer, Lou Pauly, Cranford Pratt, Rajesh Puliyara, Dagmar Raczynski, Ciska Raventós, Don Robotham, Jorge Rovira, Gavin Alderson Smith, and Anil Varughese.

The authors have drawn heavily on the extensive research on Kerala, Costa Rica, Mauritius, and Chile of historians and social scientists who are nationals of the country they study. We wish not only to acknowledge this debt, but also to identify a peculiar interpretive problem to which this debt gives rise. Many of the Keralite, Costa Rican, Mauritian, and Chilean researchers upon whose work we build are, appropriately, social critics. They subject their own political leaders, institutions, and movements to withering criticism, based on an acute awareness of how the reality of their countries diverges from such ideals as equality, solidarity, and participatory democracy. We have certainly been influenced by these critics. Each of the cases we have studied, considered in its own terms, seems to have fallen short of its promise. However, viewed through a
Acknowledgments

comparative lens, the democratic and social achievements of these four cases stand out and demand an explanation. It is this comparative perspective that leads us sometimes to depart from the despairing tone of much contemporary scholarship.

We also wish to acknowledge our resourceful research assistants, all of whom made significant contributions to the final work. Richard Sandbrook wishes to recognize the fine research work carried out in Mauritius by Hansa Munbauhal in 2003–2004, while she was a Masters student at the University of Mauritius. Judith Teichman thanks Sandra Dughman, a political science and law student at the University of Chile, who helped with data collection in Chile during 2003–2004. Marc Edelman gratefully acknowledges the assistance of the staff at the documentation centers of the Instituto de Investigaciones Sociales, University of Costa Rica, and the Consejo Nacional para Investigaciones Científicas y Tecnológicas. And Patrick Heller expresses his appreciation to Rajesh M. Puliyara from the Centre for Development Studies in Trivandrum, who assisted with collecting data for this project.

Last, but far from least, we thank John Haslam of Cambridge University Press, both for his encouragement throughout the writing of this book and for his prompt attention to queries or problems.
Can Latin America’s new left stimulate economic development, enhance social equity, and deepen democracy in spite of the economic and political constraints it faces? This is the first book to systematically examine the policies and performance of the left-wing governments that have risen to power in Latin America during the last decade. Featuring thorough studies of Bolivia, Brazil, Chile, and Venezuela by renowned experts, the volume argues that moderate leftist governments have attained greater, more sustainable success than their more radical, contestatory counterparts. Moderate governments in Brazil and Chile have generated solid economic growth, reduced poverty and inequality, and created innovative and fiscally sound social programs, while respecting the fundamental principles of market economics and liberal democracy. By contrast, more radical governments, exemplified by Hugo Chávez in Venezuela, have expanded state intervention and popular participation and attained some short-term economic and social successes, but they have provoked severe conflict, undermined democracy, and failed to ensure the economic and institutional sustainability of their policy projects.

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Wendy Hunter, Associate Professor of Government at the University of Texas, is the author of Politicians against Soldiers: Eroding Military Influence in Brazil (1997) and numerous articles and book chapters on the military and social policy issues in Latin America, as well as on the Workers’ Party in Brazil. Journals in which her articles appear include Comparative Politics, the American Political Science Review, Comparative Political Studies, World Politics, and Latin American Politics and Society. She is currently finishing a book on the Workers’ Party in Brazil.
Leftist Governments in Latin America

*Successes and Shortcomings*

Edited by

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*University of Texas, Austin*

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Acknowledgments

When working on a book, one incurs a number of intellectual, professional, and personal debts. This is even more the case with an edited volume, which is by its very nature a collaborative enterprise.

In many ways, our primary debt of gratitude is to the University of Texas at Austin (UT). Its financial and administrative support and its wealth of superb faculty have made this project feasible, manageable, and even enjoyable. Specifically, we are grateful to Bryan Roberts, Director of UT’s Lozano Long Institute of Latin American Studies (LLILAS) at the time, for suggesting the idea of holding the conference on which this book is based. Bryan’s backing and support have been crucial. We also thank LLILAS’s student interns and especially Paloma Díaz, who, in her usual indefatigable way, did an outstanding job organizing and running the conference. For generous financial support for the meeting and the resulting book, we thank LLILAS; the Department of Government and its chair Gary Freeman; the Office of Development; and the Sterling Clark Holloway Centennial Lectureship in Liberal Arts.

The conference, titled “The Performance of Leftist Governments in Latin America: What Does the Left Do Right?” was held at UT in March 2008 and featured two days of lively, stimulating debates. We thank all the paper presenters, discussants, panel chairs, and audience participants. In addition to the chapter authors featured in this volume, we are particularly grateful to Steve Ellner, Linda Farthing, Ricardo Ffrench-Davis, Benjamin Kohl, Steven Levitsky, and our keynote speaker, Chile’s former President Ricardo Lagos.

Riitta Koivumäki did an excellent job helping us put together this volume, and Ruth Homrighaus skillfully smoothened out the prose. The comments and suggestions we received from Cambridge’s anonymous reviewers greatly improved the volume. In particular, they helped us to sharpen our central arguments and advance a clear message on a topic that has attracted enormous attention and debate, inside and outside of academia. We are very thankful to our editor Eric Crahan for accompanying this project since its early stages and for shepherding it expeditiously and with exemplary professionalism through the process.
the review process. We are grateful to Shana Meyer of Aptara for her excellent organization and oversight of the production process.

Collaborating on a large and difficult project over an extended time frame can be a source of tension, if not conflict. Not in our case! Instead, editing this book has further strengthened the long-standing professional and personal cooperation among the editors, and we are very grateful for that. The resulting volume is dedicated to our children, Andi and Niko Hunter Weyland, and Bela and Nico Madrid.
## Acronyms and Abbreviations

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>ADN</td>
<td>Acción Democrática Nacionalista (Nationalist Democratic Action, Bolivia)</td>
</tr>
<tr>
<td>AFP</td>
<td>Administrador de fondo de pensión (Pension fund administrator)</td>
</tr>
<tr>
<td>ALBA</td>
<td>Alternativa Bolivariana para los Pueblos de Nuestra América (Bolivarian Alternative for the Americas)</td>
</tr>
<tr>
<td>ANC</td>
<td>Asamblea Nacional Constituyente (National Constituent Assembly, Venezuela)</td>
</tr>
<tr>
<td>ATPDEA</td>
<td>Andean Trade Promotion and Drug Eradication Act (United States)</td>
</tr>
<tr>
<td>BANFOANDES</td>
<td>Banco de Fomento Regional Los Andes (National Bank, Venezuela)</td>
</tr>
<tr>
<td>BG</td>
<td>British Gas</td>
</tr>
<tr>
<td>BNDES</td>
<td>Banco Nacional de Desenvolvimento Econômico e Social (National Bank for Economic and Social Development, Brazil)</td>
</tr>
<tr>
<td>BP</td>
<td>British Petroleum</td>
</tr>
<tr>
<td>BPC</td>
<td>Benefício de Prestação Continuada (Continuous Cash Benefit Program, Brazil)</td>
</tr>
<tr>
<td>CADIVI</td>
<td>Comisión de Administración de Divisas (Commission for the Administration of Currency, Venezuela)</td>
</tr>
<tr>
<td>CANEB</td>
<td>Cámara Nacional de Exportadores de Bolivia (National Chamber of Exporters of Bolivia)</td>
</tr>
<tr>
<td>CANTV</td>
<td>Compañía Anónima Nacional de Teléfonos de Venezuela (National Telephone Company of Venezuela)</td>
</tr>
<tr>
<td>CNT</td>
<td>Confederación Nacional del Transporte (National Confederation of the Transport Sector, Brazil)</td>
</tr>
<tr>
<td>Coca-Cola FEMSA</td>
<td>Coca-Cola Fomento Económico Mexicano, S.A. (Bottler company of Coca-Cola, Mexico)</td>
</tr>
<tr>
<td>Acronym</td>
<td>Full Form</td>
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<tr>
<td>CPMF</td>
<td>Contribuição Provisória sobre a Movimentação ou Transmissão de Valores e de Créditos e Direitos de Natureza Financeira (Tax on financial transactions, Brazil)</td>
</tr>
<tr>
<td>ECLAC</td>
<td>Economic Commission for Latin America and the Caribbean</td>
</tr>
<tr>
<td>FA</td>
<td>Frente Amplio (Broad Front, Uruguay)</td>
</tr>
<tr>
<td>FONASA</td>
<td>Fondo Nacional de Salud (National Health Fund, Chile)</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross domestic product</td>
</tr>
<tr>
<td>G7</td>
<td>Group of Seven, meeting of finance ministers from seven leading industrialized nations</td>
</tr>
<tr>
<td>IBCE</td>
<td>Instituto Boliviano de Comercio Exterior (Bolivian Foreign Trade Institute)</td>
</tr>
<tr>
<td>IBGE</td>
<td>Instituto Brasileiro de Geografia e Estatística (Brazilian Institute of Geography and Statistics)</td>
</tr>
<tr>
<td>IBOPE</td>
<td>Instituto Brasileiro de Opinião Pública e Estatística (Brazilian Institute of Public Opinion and Statistics)</td>
</tr>
<tr>
<td>ICSID</td>
<td>International Center for the Settlement of Investment Disputes</td>
</tr>
<tr>
<td>IDH</td>
<td>Índice de Desarrollo Humano (Human Development Index)</td>
</tr>
<tr>
<td>IEDI</td>
<td>Instituto de Estudos para o Desenvolvimento Industrial (Institute for the Study of Industrial Development, Brazil)</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>INE</td>
<td>Instituto Nacional de Estadística (National Institute of Statistics, Bolivia)</td>
</tr>
<tr>
<td>IPEA</td>
<td>Instituto de Pesquisa Econômica Aplicada (Institute of Applied Economic Research, Brazil)</td>
</tr>
<tr>
<td>IPEADATA</td>
<td>Instituto de Pesquisa Econômica Aplicada, Base de Dados (Database of Institute of Applied Economic Research, Brazil)</td>
</tr>
<tr>
<td>ISAPRE</td>
<td>Institución de Salud Previsional (Health insurance fund, Chile)</td>
</tr>
<tr>
<td>ISI</td>
<td>Import-substitution industrialization</td>
</tr>
<tr>
<td>IVA</td>
<td>Impuesto al Valor Agregado (Value-added tax)</td>
</tr>
<tr>
<td>MAS</td>
<td>Movimiento al Socialismo (Movement toward Socialism, Bolivia)</td>
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<tr>
<td>MAS</td>
<td>Movimiento al Socialismo (Movement toward Socialism, Venezuela)</td>
</tr>
<tr>
<td>MBR-200</td>
<td>Movimiento Bolivariano Revolucionario-200 (Bolivarian Revolutionary Movement 200, Venezuela)</td>
</tr>
<tr>
<td>MDG</td>
<td>Millennium Development Goal</td>
</tr>
<tr>
<td>MDS</td>
<td>Ministério do Desenvolvimento Social e Combate à Fome (Ministry of Social Development and Fight against Hunger, Brazil)</td>
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<tr>
<td>Acronyms and Abbreviations</td>
<td>Meaning</td>
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<td>---------------------------</td>
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<tr>
<td>MERCAL</td>
<td>Mission Mercal (National food distribution chain, Venezuela)</td>
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<tr>
<td>MIR</td>
<td>Movimiento de la Izquierda Revolucionaria (Movement of the Revolutionary Left, Bolivia)</td>
</tr>
<tr>
<td>MNR</td>
<td>Movimiento Nacionalista Revolucionario (Nationalist Revolutionary Movement, Bolivia)</td>
</tr>
<tr>
<td>MST</td>
<td>Movimiento dos Sem Terra (Landless Movement, Brazil)</td>
</tr>
<tr>
<td>MVR</td>
<td>Movimiento V [Quinta] República (Fifth Republic Movement, Venezuela)</td>
</tr>
<tr>
<td>NASA</td>
<td>National Aeronautics and Space Administration (United States)</td>
</tr>
<tr>
<td>NDP</td>
<td>National Development Plan (Bolivia)</td>
</tr>
<tr>
<td>NGO</td>
<td>Non-governmental organization</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for Economic Cooperation and Development</td>
</tr>
<tr>
<td>OPEC</td>
<td>Organization of Petroleum Exporting Countries</td>
</tr>
<tr>
<td>PAC</td>
<td>Programa de Aceleración do Crescimento (Growth Acceleration Program, Brazil)</td>
</tr>
<tr>
<td>PDC</td>
<td>Partido Demócrata Cristiano de Chile (Christian Democratic Party)</td>
</tr>
<tr>
<td>PDVSA Petrobras</td>
<td>Petróleos de Venezuela, S.A. (Petroleum of Venezuela)</td>
</tr>
<tr>
<td>Plan AUGE</td>
<td>Plan de Acceso Universal con Garantías Explicitas de Salud (Plan of Universal Access with Explicit Guarantees in Health, Chile)</td>
</tr>
<tr>
<td>PNUD</td>
<td>Programa de Naciones Unidas para el Desarrollo (United Nations Development Programme)</td>
</tr>
<tr>
<td>PODEMOS</td>
<td>Poder Democrático y Social (Social and Democratic Power, Bolivia)</td>
</tr>
<tr>
<td>PPD</td>
<td>Partido por la Democracia (Party for Democracy, Chile)</td>
</tr>
<tr>
<td>PPI</td>
<td>Programa de Promoción del Investigador (Program for Promotion of Investigators, Venezuela)</td>
</tr>
<tr>
<td>PPT</td>
<td>Patria Para Todos (Fatherland for All, Venezuela)</td>
</tr>
<tr>
<td>PRN</td>
<td>Partido da Reconstrucção Nacional (National Reconstruction Party, Brazil)</td>
</tr>
<tr>
<td>PS</td>
<td>Partido Socialista de Chile (Socialist Party of Chile)</td>
</tr>
<tr>
<td>PSDB</td>
<td>Partido da Social Democracia Brasileira (Party of Brazilian Social Democracy)</td>
</tr>
<tr>
<td>PSU</td>
<td>Prueba de Selección Universitaria (Exam for University Selection, Chile)</td>
</tr>
<tr>
<td>PSUV</td>
<td>Partido Socialista Unido de Venezuela (United Socialist Party of Venezuela)</td>
</tr>
<tr>
<td>PT</td>
<td>Partido dos Trabalhadores (Workers’ Party, Brazil)</td>
</tr>
<tr>
<td>RCTV</td>
<td>Radio Caracas Televisión (Private media company, Venezuela)</td>
</tr>
</tbody>
</table>
Acronyms and Abbreviations

RN Renovación Nacional (National Renewal, Chile)
SENIA T Servicio Nacional Integrado de Administración Aduanera y Tributaria (Integrated National Customs and Tax Administration Service, Venezuela)
SERNAM Servicio Nacional de la Mujer (National Women’s Service, Chile)
SUNACOOP Superintendencia Nacional de Cooperativas (National Superintendency of Cooperatives, Venezuela)
UDAPE Unidad de Análisis de Políticas Sociales y Económicas (Social and Economic Policy Analysis Unit, Bolivia)
UDI Unión Demócrata Independiente (Independent Democratic Union, Chile)
UN Frente de Unidad Nacional (National Unity Front, Bolivia)
UNDP United Nations Development Programme
UNT Unión Nacional de Trabajadores de Venezuela (National Workers’ Union of Venezuela)
VENEPAL (Compañía) Venezolana de Papel (Venezuelan Paper Firm)
YPFB Yacimientos Petrolíferos Fiscales Bolivianos (Bolivian State Petroleum Fields)
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Human Development, State Transformation and the Politics of the Developmental State


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*Brown University*

[This version submitted: June 15, 2012]

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ABSTRACT

The concept of the “developmental state” has been transformed over the course of the last thirty years. Since East Asian successes brought the concept into vogue in the 1980’s and 1990’s, theoretical and empirical work has transformed the concept into a general ideal type whose relevance transcends East Asia. While debates on the developmental state are still marked by the original use of the concept to analyze East Asian strategies of industrial transformation, social scientists have begun to supersede these origins, just as the states themselves have superseded them. This paper is intended as a contribution to that task.

Development economics now acknowledges that expanding human capabilities trumps capital accumulation as a driver of economic growth as well as of development more broadly defined. Refocusing attention from capital accumulation to human development entails rethinking the role of the developmental state. Coherent state apparatuses, able to deliver collective goods have become more important than ever, but the state-society relations required for success have changed. Close ties with industrial elites are no longer sufficient and may be counter-productive. Diversely structured networks that create effective ties to a broad cross-section of civil society become essential and democratic deepening appears to have become a key feature of success.

In addition to reviewing the conceptual issues involved in theorizing the transformation of the developmental state, we bring three pairs of cases to bear on the argument. The parallel transformations of the key original cases – Korea and Taiwan – over the course of the last thirty years are used to make the case for the changing character of the developmental state. The differential success of two major developing countries in constructing effective developmental states – South Africa and Brazil – is used to support the proposition that the ability to deliver human development outcomes depends on democratic deepening as much as it does on technocratic capacity. Finally, examination of the performance of the two giants of the global South – India and China – serves to underline the hypothesis that the increasing political power of capital may undermine the capacity of the developmental state in the absence of countervailing increases in democratic engagement and accountability.
The idea of the “developmental state” has proved one of the most robust, charismatic concepts in development theory. In the 1980’s and 1990’s, the concept played two roles in developmental debates. First, it provided a coherent counter to the dominant neo-liberal narrative that portrayed the market as the master institution underlying both growth and welfare. Second, it focused attention on the extraordinary success of economic transformation in the East Asia region. By the turn of the millennium the application of concept had spread beyond these origins, but it is still useful to recall its beginnings.

Chalmers Johnson (1982) deserves credit for having used the concept of the developmental state to explain Japan’s rebirth from the ashes of World War II as an industrial power, but Korea and Taiwan, especially as portrayed in the influential work of Amsden (1989) and Wade (1990) were the iconic cases. Korea and Taiwan were even more powerful cases for the transformative role of the state than Japan. Japan had been an imperial power with sufficient industrial capacity to undertake a world war before the period described by Johnson. Korea and Taiwan were former colonies with income levels below those of the more successful countries of Africa in the immediate post World War II period. When analysts like Amsden and Wade laid out connections between state structures and strategies and the ability of these countries to create globally competitive industrial sectors, the impact on developmental debates was fundamental (see the discussion in Lange introduction to this section, as well as Evans 1995).

We will not review these seminal formulations or the early history of the key cases on which they were based in any detail. Our aim instead is to focus on the more recent transformations of the developmental state. One task is updating understanding of original developmental states themselves by chronicling their historical transformation. The classic characterizations of the development state in Korea and Taiwan are focused on the period from the mid-1960’s through the mid-1980’s. Any contemporary discussion of the developmental must take equal account of the evolution of these iconic cases from the 1980’s to the present.

Even more important, however, is looking at the developmental state as a theoretical concept rather than as a description of a particular set of state apparatuses
during a particular historical conjuncture. Removing traditional Anglo-Saxon blinders and admitting that successful developmental outcomes depend on particular configurations of the state apparatus itself and its relations to society is a start. One must then ask what are the particular structural characteristics associated with developmental success and what are the political and organizational dynamics of their evolution? This in turn requires locating the analysis of the developmental state within a more general theory of what outcomes constitute “development” and what inputs are most crucial to producing those outcomes.

We will begin with by setting out the general theoretical approach to development that underlies our understanding of the developmental state. Its core is “Senian,” emphasizing the essential role of expanding human capabilities, not just as the ultimate goal of development but also as an essential means for generating the increased productivity that is the foundation of economic growth (Sen, 1999). We will then elaborate the implications of that perspective for re-conceptualizing the developmental state. The bureaucratic capacity of the developmental state looks even more important than classic analyses suggested. The analysis of the politics of the developmental state, however, requires serious revision. Rather than being a relatively simple politics of rational but authoritarian efforts to realize a national project of accumulation, the politics of the developmental state become the complex and often ambiguous politics of democratic deepening.

We flesh out this theoretical understanding of the developmental state by looking at three pairs of case studies. First, we will turn to the parallel evolution of the iconic developmental states during the last three decades – Korea and Taiwan. Then we will look at Brazil and South Africa – two major developing states that have been characterized as at least partial embodiments of the developmental state, but have taken divergent paths during the period under consideration. Finally, we will look at the two giants of the Global South – India and China. While neither of these two states has been traditionally considered a classic developmental state, they are key cases for any general understanding the connection between state structures, state-society relations and developmental outcomes. In the empirical analysis as in the theoretical discussion, our
emphasis is on the political complexities of connecting the state to civil society in a way that enables a broad-based expansion of human capabilities.

**Development Theory and the Developmental State**

Understandings of the role of the developmental state have changed, first of all, because development theory has changed. Amartya Sen’s (1999) capability approach to development converges modern models of growth. Sen’s focus on expansion of human capabilities as both the paramount goal of development and the leading means of achieving economic growth dovetails with a variety of strands in “modern economics.” It fits nicely with conventional econometric wisdom regarding the powerful role of “human capital” in generating economic growth. It also fits with the theoretical arguments and empirical evidence put forward by new growth theorists who have made the case that creating and utilizing new ideas was more important to twentieth century growth than the accumulation of plants, equipment and other tangible capital.

Traditional, mid-twentieth century economic thinking was often read as arguing that the accumulation of capital was the driver of growth and growth was the cause of improvements in health, education and well-being. Current research on economic growth emphasizes improvements in human development indicators as causing growth in income. The evidence is rich, varied and incontrovertible.

In a series of econometric papers, Ranis, Stewart and their collaborators looked at the interactions between growth and human development. Their data analysis “contradicts the conventional view that HD [human development] is purely a result of, as opposed to being a critical input into long run expansions in EG [economic growth] (Boozer et al. 2003, 25). They conclude that “HD [human development] improvements must precede growth-oriented policies if growth is to be sustained.” This argument

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1 Sen (1999, 18) argues that “well-being” involves more than increasing contentment or reducing suffering; it involves the capacity of human beings to do the things that they want to do. Thinking in terms of “capabilities” rather than just “well-being” draws our attention to the fact that human capabilities are both ends in themselves and the key means to intermediate goals, such as economic growth and the construction of democratic institutions that help us to “lead the kind of lives we value”.

2 The “new growth theory” as put forward by theorists like Lucas and Romer, built on early work by Solow and has been subsequently developed by a range of economists like Aghion and Howitt (1998) and Helpman (2004).

3 See Ranis, Stewart and Ramirez, 2000; Boozer, et al., 2003; Ranis and Stewart, 2006.
expands on the classic work of Barro and Lee (see Barro, 1997) demonstrating the powerful growth consequences of investment in education. Recent work by Hanushek and Woessmann (2008, 2009) using cognitive skills rather than years of education shows how better measurements would further strengthen the dominant role of human capability expansion in propelling growth as well as development in its full sense.

The connection between capability expansion and growth is robust across a wide range of economic levels and strategies. On the one hand, as Nugent and Robinson argue (2010) even in agricultural economies, such as Central American coffee producers, more egalitarian economic orders that give peasants incentives to invest in their own capabilities have better growth records. At the other end of the spectrum, Huo and Stephens (this volume) chronicle the effectiveness of the “social investment state” in Scandinavia at promoting growth built around a shift to knowledge-intensive production and high tech industries. Obviously, the specifics of the capabilities being fostered and the strategies of fostering them are quite different depending on the kind of production involved, but the connection between capability expansion and growth is robust across a wide range of economic contexts.

The shift to capability-centered theories of development also dovetails nicely with the resuscitation of classic concerns with the relation between inequality and development. As Huber and Stephens (2012) point out, there is a strong correlation between inequality and poverty and more specifically between educational inequality and lower overall educational attainment. A large literature confirms the destructive consequences of inequality for individual and community well-being, even in the most affluent societies (see Wilkinson 2005; Hacker 2006; Zuberi 2006). Cross national data shows a relation between lower levels of inequality and increased longevity. There is now a wealth of evidence that inequality can slow and even negate the poverty-reducing impact of growth and the World Bank now recognizes that inequality has perverse effects on institutions and undermines “good governance” (World Bank Development Report, 2006). Shifting from an accumulationist to a capability-centered focus shifts attention to new kinds of political dynamics. While the relationship between democratic political forms and income growth remains a long debated and still unresolved theoretical issue, existing research comes down in favor of a connection between accountability from
below and capability expansion. At the most rudimentary level the connection is illustrated by Sen’s proposition that independent countries with even modestly democratic political institutions do not suffer from famine. Over 25 years ago Caldwell (1986) famously argued that democracy and social activism positively contributed to superior health outcomes especially in low-income countries. More recently, a careful econometric study by Besley and Kudamatsu (2006, 1) concludes: “The data show a strong (conditional) correlation between life expectancy and democracy. This relationship is robust to controlling for the initial level of human capital as well as political histories. The data also suggest that health policy interventions are superior in democracies.”

Likewise, McGuire (2010) provides both quantitative evidence and 8 careful case studies to demonstrate the link between democracy and health outcomes, a link he argues results from the heightened expectations that citizens in democratic societies have for broad-based provisioning of social services.

This empirically grounded theoretical revolution has profound implications for theories of the developmental state. If the first generation of research on the developmental state established the centrality of the state’s role in economic growth, seeing development as capability expansion makes the state’s role even more central and important. The “developmental state” that is central, however, a very different sort of developmental state than the one that was lionized in the 1980’s and 1990’s.

Re-conceptualizing the “Developmental State”:

Once development is conceptualized as capability expansion, different kinds of problem-solving challenges confront the state. Incentivizing and supporting investment in industrial activity is a complex task, but delivering quality education or health care requires even more state capacity. Industrial growth can be achieved by aligning with a fairly narrow group, deploying well-known policy instruments (e.g. subsidies, interest rates, state procurement) and can be measured against certain hard indicators (e.g. exports, manufacturing output). Delivery of high quality services requires interventions

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4 Another recent paper by Kudamatsu finds that even in Sub-Saharan Africa, where most assume that the implantation of electoral democracy has had little developmental payoff, “democratization has reduced infant mortality” (2007: 34).

that are deeper and more socially and politically intrusive than industrial policy. Because capability-enhancement is about removing unfreedoms, it butts up directly against the forms of traditional authority and organized power of clans, castes, patriarchs and challenges the political hegemony of capitalist elites as well. A state that can deliver such services is one that must have both significant infrastructural power – the power to reach into society and deliver things – as well as significant authoritative power – the power to get individuals and groups to willingly obey commands.

Since more efficient administrative structures ultimately depend on new forms of embeddedness, state-society ties are inextricably linked to state capacity. The tradeoffs between different development projects are often acute in both social and material terms. How social preferences are formed becomes key, and this in effect puts a premium on deliberation and coordination, two functions that require intensive engagement with those impacted by decisions.\(^6\) Therefore, we argue that it is certain democratic forms of embeddedness – a concept we elaborate in more detail below – that are most likely to strengthen capability-enhancing state interventions.

Without multiple channels to source accurate information and continuous feedback loops that allow for policy-corrections, the developmental state will end up investing inefficiently and wasting precious public resources. The centrality of accurate information makes deliberative institutions key contributors to development as well as building blocks for democratic politics. While organizational and institutional forms will vary depending on the cultural and historical context, effective mechanisms of deliberation that include a broad cross-section of society is the foundation of effective public policy (Evans 2004).

The continuous monitoring and feedback of civil society sensors can radically reduce leakage and improve both the quality and quantity of delivery, especially for goods that can not be readily standardized (e.g. quality education, local planning). Active participation by citizens is in fact a key ingredient for many social policies. Education is co-produced by students (and their families). Health is “co-produced” by patients, their families and their communities (Ostrom 1996). Environmental regulation is effective

\(^6\) This is what leads a long line of thinkers as diverse as Habermas (1996), Sen (1999) and Rodrik (1997) to identify democratic deliberation as *the* meta-capability.
only when the state has allies in civil society capable of monitoring and exposing 
environmental problems. Indeed, following the line of reasoning developed in the new 
heterodox theories of industrial policy that point to the need for continuous 
experimentation, feedback and bootstrapping (Rodrik 2007; Sabel 1995), it can be argued 
that intense state-civil society interactions are key to policy innovation (Baiocchi, Heller 
and Melo 2011).

Effective state-society linkages depend on the organization of civil society as well 
as on the capacity of the state, but the state can help facilitate the organization of “civil 
society.” The twentieth century developmental state’s interaction with industrial elites 
gave these elites a reason to become a more collectively coherent class. The twenty-first 
century developmental state needs to undertake a similar but more difficult task: 
constructing shared coherent goals whose concrete implementation can then be “co-
produced” by public agencies and the communities themselves.

The importance of building engagement with a broad cross-section of civil society 
is increased by the contradictions between the increasingly globalized agenda of capital 
and a project of development as capability expansion. The old model of a shared national 
project of transformation uniting “national” capital and the state looks increasingly 
anachronistic. Even if the profit-maximizing strategies of capital were still nationally 
focused, the logic of private profit is harder to harness to capability expansion projects. 
The large “collective goods” element in capability-expansion makes it harder to construct 
productive alliances with private capital. Social returns to the expansion of human 
capabilities are substantially higher than private returns, and firms are likely to channel 
investment to areas where total returns are lower but private returns appear higher.

Our basic general argument can be reiterated in simple terms:

1) Competent, coherent public bureaucracies are even more important than we 
thought they were. Without them, capability-expanding public services will not be 
effectively designed, say nothing of delivered.

2) The ability of the state to pursue collective goals, rather than responding to the 
subjectively defined, immediate, particularistic demands of elites, is even more essential 
than earlier work on the developmental state suggested.
3) “Embeddedness” – the dense sets of interactive ties that connect the apparatus of the state administratively and politically to civil society – not only becomes more important but must focus on a broad cross-section of civil society rather than focusing simply on industrial elites.

4) State effectiveness is not so much a technocratic problem as a political problem and state-society relations are at the heart of the politics involved.

In short, the transformation of the state requires re-directing analytical attention from technocratic politics that are either internal to the state or connect it to a restricted set of elite allies and focusing instead on how the state apparatus is connected to that analytically problematic set of actors referred to as “civil society.”

The Politics of the Developmental State

The character of society is as central to the politics of state-society relations as the character of the state. Sadly, we must abandon the notion that there is a single, coherent and potentially efficacious historical subject that can act as the interlocutor of the developmental state – whether the working class or a national bourgeoisie – and admit that the state’s most crucial interlocutor is in fact that most ambiguous and ambivalent of actors – “civil society.”7 While an ideal typical civil society is at the core of democratic politics, the associational life that is at the core of civil society is not inherently democratizing. Some associations are clearly uncivil, formed for the purposes of denying other groups their associational rights (e.g. Hindu-chauvinist groups in India, the KKK in the US). Whether civil society expands rights-based conceptions of democratic inclusion, serves and an extension of state hegemony (Burawoy 2003) or devolves into involutionary forms of retrenchment (Castells 2003) is an empirical question.

7 We define civil society as the full range of voluntary associations and movements that operate outside the market, the state and primary affiliations and that specifically orient themselves to shaping the public sphere. This would include social movements, unions, advocacy groups and autonomous NGOs and CBOs. From a sociological perspective, actors in civil society rely primarily on “social (as opposed to legal/bureaucratic or market) modes of mediation among people [organizing collective action] through language, norms, shared purposes, and agreements” (Warren 2001, 8). This civic (Varshney 2002) or communicative (Habermas 1996) mode of action is as such distinct from the pursuit of political power, profits or the reproduction of primary ties and identities.
A strong civil society – one that is internally well organized and capable of autonomous action – can on balance be democratizing for two reasons. First, in an established civil society, one that is backed by the rule of law, the basis of legitimacy for all civil society groups is the pursuit of rights (Sommers 2008). Of course, rights can be expressed in exclusionary terms, but these are hard to defend as legitimate in the public sphere. Civil society in other words has a bias towards universalistic claims-making.\(^8\)

Second, a functioning civil society is one that allows for associational freedoms. These in turn give subordinate groups the possibility of collective action, a possibility enhanced by a more open civil society (Rueschemeyer, Stephens and Stephens 1992; Huber and Stephens, 2012).

Effective electoral competition is the \textit{sine qua non} of any democracy and critical to an effective civil society. By holding those who control the state periodically accountable to electoral majorities, electoral competition holds the permanent capture of power by particular elite groups in check and creates the possibilities for challenges to the status quo. Nonetheless, elections and party competition are very blunt instruments of accountability. Absent party discipline or a vigilant civil society, the default mode of competitive politics is clientelism. While electoral democracies in the Global South have dramatically expanded the spaces for subordinate politics\(^9\) pervasive inequalities between citizens and severe problems in preserving the chain of sovereignty between citizen and state have limited the effective representivity of democratic institutions (Törnquist 2009). These fundamental deficits of representative democracy in the Global South have hampered subordinate group collective action and severely restricted the possibilities for building effective welfare states.

\(^8\) See also Tilly’s argument that while some social movements often press particularistic claims, they nonetheless expand possibilities for subordinate claims:

Social movements assert popular sovereignty… the stress on popular consent fundamentally challenges divine right to kingship, traditional inheritance of rule, warlord control and aristocratic predominance. Even in systems of representative government … social movements pose a crucial question: do sovereignty and its accumulated wisdom lie in the legislature or in the people it claims to represent? (2004:13).

\(^9\) The increased mobilization of lower castes in India of the past two decades (Yadav 2000) and the dramatic rise of indigenous political power in the Andean nations (Yashar 2005) are only two examples.
To connect electoral representation to substantive outcomes subordinate groups must be able to meaningfully practice formal political rights and to leverage them to demand social rights. Much as Polanyi (1944) argued that civil society represented a countervailing force to the market, a civil society in which disprivileged groups have developed effective means of engaging parties and the state serves as a countervailing force to the deficits of representative democracy. Civil society can also have more mundane, but equally democratizing, effects by supporting continuous, detailed and interstitial feedback. The multiple associations, medias, issue networks and publics that constitute a vibrant civil society are in fact an array of highly sensitive sensors that both transmit information to states and transmit information about states and state actions back to society.

Focusing on “civil society” as the key interlocutor of a developmental state apparatus is less analytically comfortable than assuming that the state’s societal counterpart is a unified political actor such as the working class or “national capital” but such a perspective is not without historical precedent. The developmental capacity of the European social democracies was founded on the strength of encompassing multi-class alliances. Solidaristic class politics did not emerge spontaneously, but were forged in the public spaces of bourgeois democracies, through a range of associations (from unions to book clubs) and through episodic periods of social mobilization. And many of the core ideas – both in terms of widely held norms and innovative social policies – that would eventually set the stage for social democracy had their origins in local government efforts to address labor-capital conflicts (Rothstein 1999).

The comparative literature on European welfare states establishes a fairly direct tie between developmental success and embeddedness: the degree, scope and encompassingness of working class mobilization is directly correlated with the size and depth of the welfare state, which is in turn directly correlated with more egalitarian economic and social outcomes (Huber and Stephens 2001). Remarkably, the model has prospered in the post-industrial, knowledge-intensive economy: increased social investments, including advanced and flexible human capital formation and new forms of social support have enabled social democracies to successfully adapt to the competitive challenges of globalization (Huo and Stephens, this volume; Kristensen and Lilja 2012).
This is not to say that the analytic frame used for looking at social democracies in the North can simply be transposed to capability-enhancing states in the 21st century Global South. The conditions of capitalist development in the Global South have never been favorable to a politics based on the formation of a traditional working class. Nonetheless, the link between subordinate class politics, robust civil societies and social development in the Global South does apply. Sandbrook, Edelman, Heller and Teichman (2007), for example, examine a set of cases of southern social democracies that have replicated significant aspects of the developmental state despite being tiny countries fully subject to forces of global markets. Their politics were driven by subordinate class mobilization even though the mass protagonist was a quite diverse assemblage of subordinate classes, including, along with a small but active working class, landless laborers and small farmers. These class fractions converged into mobilized political forces through iterated political struggles that took place in what were relatively open civil societies. The key point here, and the parallel with the history of northern European social democracies, is that a politics of solidarity emerged out of civil society and became the basis for a broadly-based embedded developmental state.

Huber and Stephens (2012:253) make a similar argument with respect to the connections between class mobilization, party politics and state policies in contemporary Latin America, arguing that mass parties with “relations to civil society organizations, most prominently unions” are more likely to be “aggressively redistributive and universalistic in their policy proposals.” From his rather unique vantage point, former president of Brazil and sociologist Fernando H. Cardoso reinforces this point when he notes that in “Latin America social democracy is a political response to the need for fast integration of poor masses, conducted through a broad and dynamic partnership between state and civil society, energized by an active public opinion … It is this diffuse public opinion, more than political parties or specific social classes, that stimulates government action and holds it accountable for reducing poverty and inequality” (2008, 312).

There are solid grounds for identifying civil society as the key interlocutor of a developmental state, but the complex ambiguities of civil society as a composite social

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10 Costa Rica, Chile, Mauritius and Kerala
actor undermine any simple formula for predicting how the politics of synergy between a potential developmental state and civil society will play out. The concrete examination of historical cases is the best vehicle for exploring the role of state-society relations in the transformation of the developmental state.

**Empirical Variations in Development and State Transformation**

In order to move from general arguments to more nuanced analysis of the political dynamics of the developmental state, we will examine three pairs of countries: 1) Korea and Taiwan: two archetypes of the twentieth century developmental state, which have evolved in parallel since their initial periods of industrial success and, for reasons still not fully understood, managed to deliver exceptional performance with regard to capability expansion in the neoliberal era. 2) South Africa and Brazil: two major middle-income developing countries that have experienced contrasting trajectories in terms of capability expansion over the course of the last two decades; 3) China and India: two giants of the Global South whose ambiguous trajectories with regard to capability expansion illustrate the complexities of the dynamics of the developmental state.

**A. Korea and Taiwan as Capability Enhancing States:** The state capacities exhibited in Korea and Taiwan’s successful industrial transformations have been well-specified. The coherence and quality of the bureaucratic apparatus combined with the ability to create dense ties to industrial elites, made it possible for political elites to construct a transformative economic response to their geopolitical vulnerabilities. The centrality of capability expansion to the economic success of the East Asian tigers has, however, been relatively neglected. Even during their initial drives for industrial transformation, these states were pioneers in capability expansion, renowned for their levels of investment in human capital. They began their periods of accelerated economic growth with education levels that made them outliers for countries at their income levels and continued to invest in the expansion of education throughout the period of their rapid expansion.

If we refocus on these states in the last 30 years, the centrality of capability expansion to their development strategies becomes more explicit. As both Korea and Taiwan moved toward democratization in the 1980’s, these states began a notable
expansion of social protection (see Wong 2004; Peng and Wong 2008; Dostal 2010; McGuire, 2010). The last quarter century has been a period of socio-political transformation that looks more than anything else like an effort to construct a 21st century East Asian version of post World War II Golden Age social democracy.

Over the course of the last 30 years, Korean and Taiwan stand out both in terms of their ability to preserve low levels of inequality11 and in their continued improvements in terms of the basic indicators of capability expansion, education and health (Siddiqi and Hertzman, 2001). The comparison between China and Korea that is highlighted by Drèze and Sen (2002) provides a dramatic example of Korea’s social development successes. Starting in the 1980s with levels of life expectancy comparable to China’s, Korea ends up at the end of the first decade of the new millennium with levels comparable to the EU and higher than the U.S. The divergence in the performance of China and Korea in terms of basic health indicators is as dramatic as the divergence between Brazil and South Africa (Drèze and Sen 2002, 125). Infant mortality trends provide another window on divergent ability to deliver capability expansion. In the period from 1960 to 1981, when China’s performance in terms of income growth was significantly inferior to Korea’s, China outperformed Korea in terms of reductions in infant mortality. In contrast, in the period from 1990 to 1999, improvements in infant mortality collapsed in China, despite spectacular rates of income growth, while Korea’s performance in terms of infant mortality accelerated despite lower rates of economic growth.

The politics of increased state involvement in capability expansion in Taiwan and Korea fit our general argument nicely. First, there is a clear connection between the emergence of electoral competition and state initiatives to increase investments in human capabilities. Peng and Wong (2008, 74) observe that it took only 2 years after contestation from below led to more competitive democratic politics in 1987 for Korea to move from being a “laggard” on state supported health insurance to universalized coverage.12 Likewise in Taiwan the state initiatives to provide universalized health

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11 There are, of course, countries that have consistency achieved even lower levels of inequality, with the Nordic countries being the prime examples, but in the set of countries considered here, Korea and Taiwan stand out.
12 OECD data, which now includes South Korea (but not Taiwan) shows that social expenditure in Korea climbed from 3% of GDP in 1990 to 10% in 2010 (Adema, W., P. Fron and M. Ladaique 2011).
insurance began in 1986 “precisely at the time the opposition party, the Democratic Progressive Party (DPP), was formed” (Peng and Wong 2008, 75).

Along with increased electoral competition, engagement by civil society actors played a key role. Peng and Wong (2008, 77) note that in Korea,

. . . . “organizations such as People’s Solidarity for Participatory Democracy (PSPD), the Citizen’s Coalition for Economic Justice (CCEJ), and the Women’s Association United (WAU) played central roles in directly negotiating with the government in health care and pension reform, in the extension of family and child care, and in steering the government’s attention toward gender issues in public policy more generally.”

McGuire (2010, 300) notes that a network of “progressive doctors, academics, and former democracy advocates lobbied successfully for the introduction of single-payer national health insurance” in Korea in the early 1990’s. Dostal (2010, 165) highlights “democratization and political mobilization” as the most significant factors in expanding social provision in both Korea and Taiwan (See also Wong, 2004.)

Despite the political specifics of the move toward capability expansion, skeptics might still argue that there is an inevitable “modernization” logic that pushes states in this direction once income levels pass a certain level. Huber and Niedzwiecki’s (this volume) analysis of comparative dynamics across Latin America and East argues against such an interpretation. The contrast between Brazil and South Africa makes it even clearer that a shift toward more effective capability expansion is not inevitable even among democratic, middle income states in the Global South

B. South Africa and Brazil – Cases of Divergent Capability Performance:
Brazil and South Africa both democratized over the course of the last twenty to thirty years, overcoming historical legacies of extremely inegalitarian social structures and exceptionally high levels of economic inequality. Starting in the 1990’s, newly-elected democratic political leadership in both countries shared the goal of remedying the injustices of historical inequality and expanding capabilities.

Despite their apparently similar political trajectories, South Africa and Brazil have diverged in terms of delivering well-being during recent decades of democratic rule. Instead of growth bringing greater social disparities in Brazil, as it had under the military
in the 1970’s, it was “accompanied by rising average earnings, more formal employment, greater social protection for the population as a whole, greater equality in household income and wages, and a reduction in poverty” (Kerstenetsky 2009, 15). “Bolsa Familia,” Brazil’s conditional transfer program, was small in terms of overall expenditures, but transformed the lives of tens of millions of poor Brazilians, almost a quarter of the entire population. Access to health care and education expanded as well.

In South Africa, investments in health and education have not delivered the same kind of returns. In Brazil, the rate of infant mortality was cut almost in half between 1996 and 2006. In South Africa, infant mortality increased in the same period. In Brazil, the proportion of girls in primary school rose from 83% to 95% between 1991 and 2004. In South Africa, it dropped from 92% to 88% in the same period [see World Health Organization, WHOSIS Database, http://www.who.int/whosis/en].

The divergence was even more dramatic in terms of levels of inequality. By the turn of the millennium, Brazil relinquished its 400 year old claim to being a world champion of inequality. Brazil’s efforts at reducing its historic levels of inequality have begun to show up in the Gini Index. In addition, data shows a reduction of inequalities in very basic measures of human capabilities, such as child-stunting. Monteiro et.al. (2010) report significant reductions in the ratio of stunting in the bottom quintal of the income distribution as compared to the top quintile. They conclude (2010, 309), “The Brazilian experience is an example of the critical effect that policies to promote income redistribution and universal access to education, health, water supply, and sanitation services may have on child undernutrition.” In South Africa, in contrast, the turn of the millennium saw a disturbing shift from historically high levels of inequality to levels that were even higher.

What accounts for the ability of the Brazilian state to gain traction as a 21st century developmental state and the inability of the South African state to do likewise? It is probably not differences in traditional bureaucratic capacity. The South African state began the period with relatively high administrative capacity of the traditional developmental state type, certainly not clearly inferior to Brazil’s. A variety of
explanations might be put forward, but the relationship between “political society” [roughly the state as a political entity and political parties] and “civil society” is a very plausible candidate.

Despite the fact that both countries have vibrant civil societies in which subordinate groups have organized and made claims on the state, the relation between political society and civil society is quite different. In South Africa, the broad-based civil society organizations that emerged from the anti-apartheid struggle have “become estranged from political society” and (Heller 2011a, 15) as an electorally dominant political party, the ANC, sought to extend its hegemony over popular organizations. Participatory structures that were part of the architecture of South Africa’s new democracy were dismantled or hollowed out after the ANC unilaterally embraced neoliberal reforms in 1996 and turned to a much more technocratic and managerialist strategy of delivery. Consequently, subaltern civil society has more or less been sidelined from the political process and the past few years have seen a dramatic rise in often violent “service-delivery protests” by the urban poor.

In contrast, in Brazil, a relatively autonomous civil society that can effectively engage the state through a range of participatory institutions has emerged, generating clear instances of civil society projecting itself into the state to shape policy as well as the institutionalization of a wide range of participatory structures and the strengthening of local democratic government (Heller 2011a, 27). The “co-evolution” of party politics and civil society was the key to this process. Brazilian political parties at the time of democratization were notorious for being elite-dominated and ineffective (Baiocchi, Heller and Silva 2011). It was social movements and a vibrant sector of activist NGOs that drew the state in by demanding participatory institutions of engagement and then projecting themselves into the state. The key agent of welfare expansion in the 2nd phase of Brazil’s social turn was a political party, the PT, but a political party that nonetheless

13 It is tempting to point to the devastating effects of AIDS in South Africa as a simple explanation for the divergence. The divergent trajectory of AIDS in the two countries is, however, endogenous to differences in political institutions. Brazil’s greater effectiveness at dealing with AIDS is in itself a result of very different relations between civil society groups affected by AIDS and the state, and consequently, sharp differences in policy responses. (See for example: Gauri and Lieberman 2006).
had its origins in civil society and that despite its increasingly professional and
electorally-driven modus operandi (Hunter 2010) still maintains key ties to civil society.

In an important analysis from a different perspective, Arrighi, Ashcroft and Scully (2010) complement our argument by looking at the relationship between the South African state and capital. They start by making what is in effect an argument for the construction of a capability expanding developmental state, arguing (2010, 435) that without “structural reforms that re-invent the welfare state on foundations that can be
generalized to the vast majority of the population, the economic and social performance
of the South African state will continue to deteriorate”. They then go on to connect the
failure to move in this direction to the failure to challenge the political hegemony of the
current alliance of national and global capitalists.

The current global boom in demand for natural resources has the potential to
“provide natural-resource-rich South Africa with significant opportunities to generate
jobs, incomes, and taxable surpluses, as well as preferential market arrangements.”
(Arrighi, Ashcroft and Scully 2010, 434). If appropriated and effectively invested in
capability expansion by the state rather than left in the hands of capital, these revenues
could “be used to promote and generate activities capable of re-inventing the welfare
state on foundations that can be generalized to the vast majority of the population”.

What has happened instead, Arrighi and his collaborators, argue is that the South
African state ended up “betting on capital,” focusing its demands on “Black Economic
Empowerment,” which meant making the capitalist elite more multi-racial, rather than
claiming a larger share of the windfall profits from the resource boom. Thereby, the state
(2010, 435) “forfeited the kind of investments in the welfare of the population (housing,
public transport, health and, above all, mass lower and higher education) that would have
been key developmental objectives in themselves and may well be the most essential,
though by no means sufficient, condition of renewed economic expansion.” While it
built ties to capital, the state failed to enable civil society to engage in the “co-
production” of capability expansion.
C. India and China: Two Developing Giants

In the post World War II era China and India looked like the obvious contrast to the East Asian Tigers. In India, the Nehruvian state had bureaucratic capacity, but its transformative ambitions were stymied by “a regime of clientelist machine politics, fostered by a flabby and heterogeneous dominant coalition preoccupied with an anarchical grabbing of public resources … “ (Bardhan 1983, 221). China’s egalitarian socialist model enabled massive, broadly distributed investment in health and education but there was no capitalist class to ally with at all. Over the course of four decades, China has become the epitome of economic dynamism and India is a close second. Yet, in recent decades as the original East Asian tigers have moved in the direction of capability expansion, China and India are seen by at least some analysts as incapable of delivering the capability expansion that helped provide the foundations of their current growth. Certainly these are telling trajectories from the point of view of any theory of the developmental state. We will start with China.

Few would deny the central role of China’s creation of an educated populace with extended life spans in creating the foundation for its economic competitiveness in the last two decades of the 20th century. Hart (2002) contrasts the success of this more capability oriented Chinese approach to the economic costs of South Africa’s neglect of capabilities. Yet, Drèze and Sen (2002) argue that just as China began to reap growth returns from its earlier investments in human development, its performance in terms of capability expansion began to falter.

One interpretation of this reversal can only be explained by highlighting the particular nature of the Chinese state’s broad-based but authoritarian embeddedness. In the aftermath of a peasant revolution, embeddedness was secured through authoritarian structures, and particularly through the organizational prowess of a highly disciplined mass-based party that could reach into villages and factory floors to deliver results. But if this form of top-down command and control power was good at universalizing access to basic capabilities, in the absence of democratic checks and balances it lacked feedback mechanisms. This is how Drèze and Sen (1989) explain the paradox that a high capacity state could preside over the Great Famine that took the lives of millions even as local party authorities kept reporting bumper crops.
While China’s overall levels of performance in terms of standard measures of capability expansion remains enviable, the rhythm of improvement in provision of key collective goods has slowed down with the transition to a more market-oriented approach, as Drèze and Sen’s data on China’s lagging performance relative to Korea with regard to reducing infant mortality in the 1990’s illustrates (see discussion above). Bardhan argues that much of the poverty reduction in China took place before foreign trade and investment began to drive growth in the 1990s. New data from the World Bank in fact shows that poverty reduction in China was mainly due to agricultural growth, which itself was tied to huge infrastructural and social investments in the socialist period (Bardhan 2010, 93-94). In areas like health care, where a poor China delivered a level of health performance that was extraordinary for a country at its level of income, current performance has become a source of concern (see for example, Wang, 2004). Chinese society has also suffered from sharply-rising income inequality and a withdrawal of prior social protections (see Davis and Wang, 2009). Economically successful “communist capitalism” has erased China’s exceptionally low levels of inequality and contributed relatively little to the high levels of social protection that had characterized China in the socialist period.

During the “communist capitalism” period, as a combination of foreign corporations and local private capitalist elite groups gained increasing access to the party and the state at the national level and at the local level in the most economically dynamic regions of the country. As a corollary of this political shift, the state (and the Party) increasingly withdrew from its traditional role of directly providing welfare. State-owned industries stopped providing workers with social benefits (danwei) and land privatization in rural areas undermined the basis of the local welfare state. As the party-state withdrew, access to housing, education and health has increasingly became dependent on the market.

Will the Chinese state shift in the direction of greater emphasis on capability expansion in the absence of democratic pressures of the type that prompted this shift in Korea and Taiwan? Hu Jintao’s recent emphasis on the “harmonious society,” the 2008 Labor Law and an apparent increase in tolerance for strikes, various efforts to re-invigorate public efforts to provide health care and a gradual shift of the state budget
toward giving “social and educational expenditures” a greater share all point toward more support for capability expansion. At the same time the continuing dispossession of the Chinese peasantry by urban land developers creates a powerful structural movement toward greater inequality and the refusal to tolerate organized challenges from civil society also makes it hard to believe that a real shift is underway.

The case of India provides further evidence of how a lack of broad-based embeddedness can undermine the capacity of a state to translate growth into capabilities, albeit under democratic conditions. Over the past two decades, the Indian state has largely failed to translate the dividend of two decades of rapid growth into higher levels of social provisioning. New Delhi has embraced policies that are aimed at capability-expansion but delivery continues to be highly top-down, more or less monopolized by the “bureaucratic-politician nexus” and subject to massive leakage.

Historically, the Gini coefficient for India has been comparatively low, but it is climbing and by some estimates has now surpassed China (Bardhan 2010, 97). But other indicators leave little doubt that there is a disconnect between dynamic growth and capability expansion. Thus, despite very significant increases in educational spending and a now near-universal rate of primary school enrollment, teacher absenteeism remains chronic, caste discrimination rampant and school failure endemic (Ramachandran 2009). The most recent comprehensive national evaluation concluded that by the end of the 5th year of education, more than half of school children have yet to acquire a second-year level of reading (ASER Centre, 2012). Even as the upper caste/classes of India reap the rewards of the global knowledge economy, World Bank data (WDR 2006) shows that India continues to be beset by levels of inequality of educational opportunity that surpass almost all Latin American countries and even some African countries. Even more striking is the complete failure to deliver the most basic of capabilities – food and health. A recent assessment found that in 2006 48% of children under the age of 5 suffered from stunting (the highest level of malnutrition in the world), a condition that has severe long-term health consequences (Government of India 2009). Annual reports of National

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14 Estimates of budgetary shifts are based on unpublished analysis by Prof. Yuen Yuen Ang, University of Michigan, Department of Political Science of data from China Public Finance Yearbook 2004, PROC Ministry of Finance.
Nutrition Monitoring Bureau actually show a decline in the consumption of calories over the past 2 decades.

How do state capacity and state-society relations figure in India’s failure to deliver capability expansion? The commanding heights of the Indian state enjoy significant capacity and some autonomy from particularistic interests, particularly in the realm of macro-economic policy. Yet as one moves downward from the centre through the sub-national state and into local government, state capacity deteriorates the more the state directly engages with society. The existence of subnational states that have demonstrated a marked capacity for enhancing capabilities, most notably Kerala, Tamil Nadu and Himachal Pradesh, while drawing on the same resources, institutional forms and bureaucratic structures of other states, suggests that the problem is more political – (the chain of sovereignty) than organizational (the chain of command) (Heller, 2011b).

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The Indian state, and in particular the subnational and local state are deeply embedded in society but only through linkages of party representation. And party representation in India has become highly fragmented and highly particularistic, reducing the state to a patronage machine (Chandra 2007). Party politics have such an exclusive hold on how the state engages with society that civil society, in a pattern that resembles South Africa, has been almost entirely shut out (Heller 2009). The Indian state as such has few sensors, no effective feedback mechanisms and no co-producers. It can deliver on macro-economic policy and some mega projects, but it can’t get teachers to teach, nurses to show up or municipalities to make their budgets transparent.

The counterfactuals are instructive. The dramatic progress in social development in the Southern states of Kerala and Tamil Nadu can be tied directly to their historical patterns of social mobilization. Broad-based anti-caste movements produced enduring encompassing political formations that not only strengthened the demand-side dynamic of civil society, but also created more competitive, redistributive party politics (Heller 2000; Harriss 2003; Ahuja 2010).

Our comparison of China and India brings more nuance to our understanding of the relationship between the capability-enhancing state and growth, and how forms of state embeddedness mediate that relationship. In the pre-market period, the Chinese state was deeply embedded through authoritarian structures in society. This form of
embeddedness facilitated rapid capability expansion and helped set the stage for China’s
dramatic economic take-off. Bardhan (2010) explicitly ties China’s greater success in
promoting capabilities and its more broad-based and diversified pattern of growth to the
fact that China has much stronger and more developmental forms of local government (in
our terms the greater institutional embeddedness of the state). But in the absence of
democratic checks, there has been little to stop an increasingly business-oriented Party
from pursuing growth at the expense of its traditional involvement in expanding
capabilities.

India has also failed to capitalize on its growth dividend and inequality is also
growing, significantly so in income terms but even more dramatically in human
capability terms. In part, the state is increasingly constrained by its determination to
promote accumulation. Kohli (2012, 213) concludes that “the narrowness of the ruling
coalition helps explain both the forces that have accelerated growth in India and the
disproportionate distribution of the fruits of that growth”. In India’s noisy and
increasingly mobilized democracy however, the imperative to facilitate accumulation has
to be balanced by the need for legitimacy. Thus the Centre has recognized the need to
enhance capabilities and has made significant efforts to tackle India’s massive deficits in
service delivery.\(^1\) But electoral imperatives in the absence of embeddedness undermine
the state’s developmental efficacy. In the absence of effective systems for delivery and
local accountability, coordination remains poor and the rate of capture remains high. In
urban areas, where much of the recent growth has been concentrated, efforts to develop
urban infrastructure and social services have been stymied by the dominance of “land-
grab” politics, as developers and politicians collude in capturing the rents of exploding
urban land prices. Drèze and Sen (2011, 9) note that celebrations of India’s growth have
to be tempered by the recognition that “[t]he growing influence of corporate interests on
public policy and democratic institutions does not particularly facilitate the reorientation
of policy priorities towards the needs of the unprivileged.” They go on to point out that
in contrast to Brazil where public expenditures accounts for more that half of health

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\(^1\) It is notable that many of these new initiatives have been in part driven organized NGOs and expert-
activists (such as Jean Drèze) and have included new laws on right-to-information, an ambitious new rural
poverty-reduction scheme and food security legislation. But such engagements remain the exception, and
in any event fall short of providing the continuous input and vigilance that co-production requires.
expenditure and has resulted in the universalization of access to primary care, in India public monies account for less than a quarter of health expenditure and that with the growing influence of commercial insurance companies the prospect of building a public health care system are not very good.

Counterfactual cases within India suggest that the problem lies less in issue of state capacity, than with the way in which the state’s relationship to society is constrained by political dynamics. State interventions continue to be captive to narrow, patronage-driven political imperatives that are highly entrenched at the sub-national and local level. In the absence of countervailing civil society organizations that can hold bureaucrats and politicians to account and more broad-based forms of demand-making that would favor the provisioning of public goods, the prospects for successful capability-expansion in India remain limited.

In both India and China, the state has failed to fully translate growth into capability expansion. In China, this is a story of broad-based but authoritarian embeddedness that has narrowed without being replaced by a complementary democratic accountability to civil society. In India, a state that was democratically accountable, but narrowly embedded, has failed to develop even the most basic capabilities. In both cases, the limits of the state’s accountability and responsiveness to subordinate groups are directly related to its increased ties to economic elites. The increasing political power of capital works in different ways in these two very different polities, but in both cases it works to undermine the engagement with civil society on which the effective production and delivery of collective goods depends.

CONCLUSION:

The conceptual analysis with which we began was premised on a sea change in development theory over the course of the last 25 years, one that has undercut the traditional preeminence of capital accumulation in favor of a perspective in which the expansion of human capabilities is both the ultimate goal and primary means of development. When applied to the developmental state, this perspective led to the
argument that if the developmental state is to play an effective role in promoting development as capability expansion the key lies in transforming state-society relations.

Our three paired comparisons of country cases reinforced the analytical argument. They revealed just how important the state is in organizing the relationship between a capitalist economy and capability-enhancing development. Because markets necessarily under supply public goods, the state plays a critical role in ensuring that growth can be translated into capability enhancement, and that capability enhancement and social investment more generally can in turn promote growth.

Promoting capabilities in the contemporary global capitalist economy requires broad-based embeddedness. In its optimal form, such embeddedness implies three things: links to a plurality of groups; multiple points of contact with the state that reduce the costs of transaction between state and society; modes of intermediation that promote co-production and coordination over domination, coercion or dependency.

In our paired studies, we have highlighted two sources of differences in the nature of embeddedness. The first has to do with how broad the state’s engagement is with society. States can be linked to select groups, or they can be articulated with more a more encompassing set of social actors and interests. If 20th century theories of the social democratic state located the source of more “encompassing” embeddedness in the formation of the working class, revisionist accounts and our interpretation of 21st century cases suggest the importance of developing more nuanced understandings of the conditions under which civil society can produce solidaristic politics. The second has to do with how that form of engagement is mediated. It can take an authoritarian form in which the state enjoys despotic power, or it can take a democratic form in which the state must negotiate the terms of its intervention with civil society. The authoritarian form can be expedient, but in the absence of countervailing forces it can be subject to the problems that Scott identified in his critique of high modernism. Authoritarian embeddedness limits the effective functioning of the development state by short-circuiting the flow of information, disincentivizing cooperation and precluding the type of institutional fine-tuning that is so critical to building effective forms of intervention. Our argument thus reaffirms Mann’s (1986) classic finding that states whose power is democratically
authorized have been much more successful in the long run in developing synergistic relations with society than authoritarian states.

Representative institutions by themselves cannot ensure that the state’s engagement with society produces developmental outcomes. A competitive party system is critical to countering the problem of elite capture. But, as the case of India underscores, even in a highly consolidated and extremely competitive electoral system, representative mechanisms can still fail to secure accountability to citizens. Electoral calculations in a majoritarian system in a diverse society can favor the logic of clientelism over the logic of public provisioning. Movement toward a more universalistic logic requires civil society organizations with a capacity for engagement and political intermediation by parties able to avoid “embedded particularism” (Herring 1999).

From our six cases we can identify three configurations of embeddedness. Brazil, Taiwan and South Korea have all achieved a form of democratic embeddedness. Though the developmental state has actively pursued market reforms and helped build economic dynamism, it has also supported capability expansion. Though the pattern of democratization itself varied significantly, in all three cases this helped create the political support for extending social services.

We lack the same depth and variety of research on the role of civil society in Taiwan and South Korea, but some preliminary propositions are still possible. There is consensus that a combination of a cross-class anti-authoritarian alliance and working class mobilization drove democratization in South Korea. Conversely, the emergence of electoral competition was fundamental in expanding the political space in which civil society organization could engage the state. Nonetheless, it is also seems clear that an increasingly active role of civil society has been critical to promoting social reforms in both countries, especially when compared with the relative quiescence of political parties themselves on social issues.

South Africa stands as a cautionary tale. Because of the anti-apartheid struggle, democratic south Africa inherited a vibrant and organized civil society, one in which rights-based discourses were powerful and subordinate groups enjoyed significant capacity for collective action. South Africa might very well have travelled the same path as Brazil, except that the dominant party status of the ANC has more or less insulated the
state from subordinate civil society. In the absence of feedback mechanisms and countervailing democratic power, state power has increasingly tended towards a form of high modernism. This has produced both policy disasters, such as the refusal by the Mbeki administration to address the HIV-AIDS pandemic, as well as a more general policy drift that has favored capital over capability-expansion.

The ambiguous cases of India and China underline both the different dynamics associated with different kinds of state society relations and the continuing importance of the state’s autonomy in relation to the agendas of capitalist elites. While it is possible to imagine paths from either India’s democratically accountable, but narrowly embedded state or China’s broad-based but authoritarian embeddedness to a more deeply democratic embeddedness that would be consistent with the effective promotion of capability expansion, it is even easier to envisage negative trajectories. These cases make it clear that there is no functionalist logic that insures the positive transformation of the developmental state.

In all three pairs of cases, as in the conceptual analysis that preceded them, politics are primary. Technocratic and organizational capacities are still fundamental to the success of the developmental state, but absent a complementary politics of encompassing engagement with a broad cross-section of society, technocratic capacity is sterile and ineffectual. In building a politics of capability expansion the state itself cannot be the only actor, nor can it rely only on elite allies. Absent an effective conglomerate of societal actors capable of embodying the roles intrinsic to “civil society” as an ideal type, the developmental state cannot deliver capability expansion. A continuous process of transformation in response to the challenges of development is the primary feature of states that succeed in remaining persistently developmental.
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