The Economist

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Special report: State capitalism

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The visible hand

The crisis of Western liberal capitalism has coincided with the rise of a powerful new form of state capitalism in emerging markets, says Adrian Wooldridge

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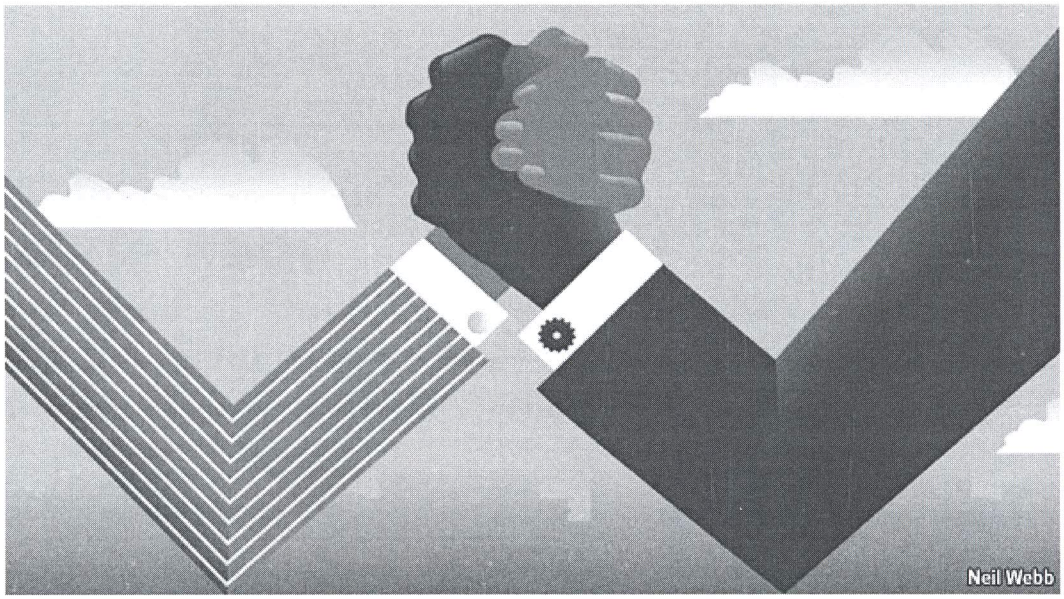


BEATRICE WEBB grew up as a fervent believer in free markets and limited government. Her father was a self-made railway tycoon and her mother an ardent free-trader. One of her family's closest friends was

Herbert Spencer, the leading philosopher of Victorian liberalism. Spencer took a shine to young Beatrice and treated her to lectures on the magic of the market, the survival of the fittest and the evils of the state. But as Beatrice grew up she began to have doubts. Why should the state not intervene in the market to order children out of chimneys and into schools, or to provide sustenance for the hungry and unemployed or to rescue failing industries? In due course Beatrice became one of the leading architects of the welfare state—and a leading apologist for Soviet communism.

The argument about the relative merits of the state and the market that preoccupied young Beatrice has been raging ever since. Between 1900 and 1970 the pro-statists had the wind in their sails. Governments started off by weaving social safety nets and ended up by nationalising huge chunks of the economy. Yet between 1970 and 2000 the free-marketeers made a comeback. Ronald Reagan and Margaret Thatcher started a fashion across the West for privatising state-run industries and pruning the welfare state. The Soviet Union and its outriggers collapsed in ruins.

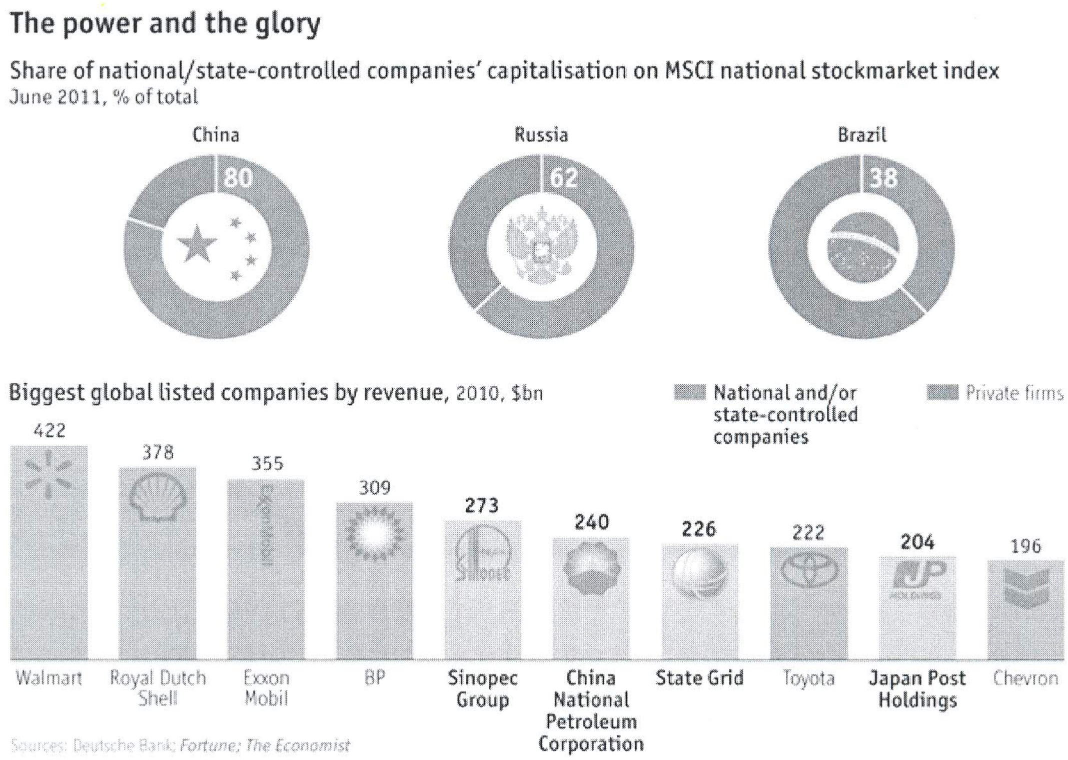
The era of free-market triumphalism has come to a juddering halt, and the crisis that destroyed Lehman Brothers in 2008 is now engulfing much of the rich world. The weakest countries, such as Greece, have already been plunged into chaos. Even the mighty United States has seen the income of the average worker contract every year for the past three years. The Fraser Institute, a Canadian think-tank, which has been measuring the progress of economic freedom for the past four decades, saw its worldwide "freedom index" rise relentlessly from 5.5 (out of 10) in 1980 to 6.7 in 2007. But then it started to move backwards.

The crisis of liberal capitalism has been rendered more serious by the rise of a potent alternative: state capitalism, which tries to meld the powers of the state with the powers of capitalism. It depends on government to pick winners and promote economic growth. But it also uses capitalist tools such as listing state-owned companies on the stockmarket and embracing globalisation. Elements of state capitalism have been seen in the past, for example in the rise of Japan in the 1950s and even of Germany in the 1870s, but never before has it operated on such a scale and with such sophisticated tools.

State capitalism can claim the world's most successful big economy for its camp. Over the past 30 years China's GDP has grown at an average rate of 9.5% a year and its international trade by 18% in volume terms. Over the past ten years its GDP has more than trebled to $11 trillion. China has taken over from Japan as the world's second-biggest economy, and from America as the world's biggest market for many consumer goods. The Chinese state is the biggest shareholder in the country's 150 biggest companies and guides and goads thousands more. It shapes the overall market by managing its currency, directing money to favoured industries and working closely with Chinese companies abroad.

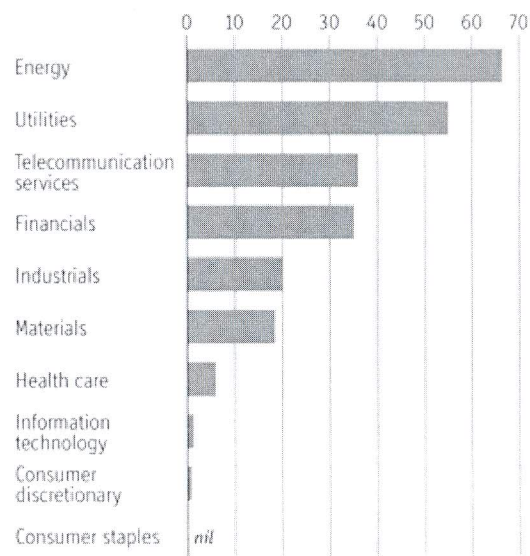
State capitalism can also claim some of the world's most powerful companies. The 13 biggest oil firms, which between them have a grip on more than three-quarters of the world's oil reserves, are all state-backed. So is the world's biggest natural-gas company, Russia's Gazprom. But successful state firms can be found in almost any industry. China Mobile is a mobile-phone goliath with 600m customers. Saudi Basic Industries Corporation is one of the world's most profitable chemical companies. Russia's Sberbank is Europe's third-largest bank by market capitalisation. Dubai Ports is the world's third-largest ports operator. The airline Emirates is growing at 20% a year.

State



capitalism is on the march, overflowing with cash and emboldened by the crisis in the West. State companies make up 80% of the value of the stockmarket in China, 62% in Russia and 38% in Brazil (see chart). They accounted for one-third of the emerging world's foreign direct investment between 2003 and 2010 and an even higher proportion of its most spectacular acquisitions, as well as a growing proportion of the very largest firms: three Chinese state-owned companies rank among the world's ten biggest companies by revenue, against only two European ones (see chart). Add the exploits of sovereign-wealth funds to the ledger, and it begins to look as if liberal capitalism is in wholesale retreat: New York's Chrysler Building (or 90% of it anyway) has fallen to Abu Dhabi and Manchester City football club to Qatar. The Chinese have a phrase for it: "The state advances while the private sector retreats." This is now happening on a global scale.

Share of national/state-controlled companies in MSCI emerging-market index by industry sector
June 2011, %



Source: Deutsche Bank

This special report will focus on the new state capitalism of the emerging world rather than the old state capitalism in Europe, because it reflects the future rather than the past. The report will look mainly at China, Russia and Brazil. The recent protests in Russia against the rigging of parliamentary elections by Vladimir Putin, the prime minister, have raised questions about the country's political stability and, by implication, the future of state capitalism there, but for the moment nothing much seems to have changed. India will not be considered in detail because, although it has some of the world's biggest state-owned companies, they are more likely to be leftovers of the Licence Raj rather than thrusting new national champions.

Today's state capitalism also represents a significant advance on its predecessors in several respects. First, it is developing on a much wider scale: China alone accounts for a fifth of the world's population. Second, it is coming together much more quickly: China and Russia have developed their formula for state capitalism only in the past decade. And third, it has far more sophisticated tools at its disposal. The modern state is more powerful than anything that has gone before: for example, the Chinese Communist Party holds files on vast numbers of its citizens. It is also far better at using capitalist tools to achieve its desired ends. Instead of handing industries to bureaucrats or cronies, it turns them into companies run by professional managers.

The return of history

This special report will cast a sceptical eye on state capitalism. It will raise doubts about the system's ability to capitalise on its successes when it wants to innovate rather than just catch up, and to correct itself if it takes a wrong turn. Managing the system's contradictions when the economy is growing rapidly is one thing; doing so when it hits a rough patch quite another. And state capitalism is plagued by cronyism and corruption.

But the report will also argue that state capitalism is the most formidable foe that liberal capitalism has faced so far. State capitalists are wrong to claim that they combine the best of both worlds, but they have learned how to avoid some of the pitfalls of earlier state-sponsored growth. And they are flourishing in the dynamic markets of the emerging world, which have been growing at an average of 5.5% a year against the rich world's 1.6% over the past few years and are likely to account for half the world's GDP by 2020.

State capitalism increasingly looks like the coming trend. The Brazilian government has forced the departure of the boss of Vale, a mining giant, for being too independent-minded. The French government has set up a sovereign-wealth fund. The South African government is talking openly about nationalising companies and creating national champions. And young economists in the World Bank and other multilateral institutions have begun to discuss embracing a new industrial policy.

That raises some tricky questions about the global economic system. How can you ensure a fair trading system if some companies enjoy the support, overt or covert, of a national government? How can you prevent governments from using companies as instruments of military power? And how can you prevent legitimate worries about fairness from shading into xenophobia and protectionism? Some of the biggest trade rows in recent years—for example, over the China National Offshore Oil Corporation's attempt to buy America's Unocal in 2005, and over Dubai Ports' purchase of several American ports—have involved state-owned enterprises. There are likely to be many more in the future.

The rise of state capitalism is also undoing many of the assumptions about the effects of globalisation. Kenichi Ohmae said the nation state was finished. Thomas Friedman argued that governments had to don the golden straitjacket of market discipline. Naomi Klein pointed out that the world's biggest companies were bigger than many countries. And Francis Fukuyama asserted that history had ended with the triumph of democratic capitalism. Now across much of the world the state is trumping the market and autocracy is triumphing over democracy.

Ian Bremmer, the president of Eurasia Group, a political-risk consultancy, claims that this is "the end of the free market" in his excellent book of that title. He exaggerates. But he is right that a striking number of governments, particularly in the emerging world, are learning how to use the market to promote political ends. The invisible hand of the market is giving way to the visible, and often authoritarian, hand of state capitalism.

Special report at a glance

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