

# Illiberal Economic Policies

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This chapter provides an overview of illiberalism as a formative line of policymaking in the economic development of the past two centuries, with a focus on the past two decades. It first provides a historical account. Second, it offers four ideal types of illiberal policies, which are considered, as success stories by those employing them. Third, we inquire if, and to what degree and under what conditions, the illiberal change in policies – which runs contrary to the policy consensus of the highly successful Great Moderation period of 1985–2007 – is likely to survive in the long run under conditions of globalization and IT revolution.

Traditionally illiberal economic policies tended to be equated by and large with populism. The latter, explained in a classic summary (Dornbusch and Edwards 1991) was by and large a form of pork-barrel policies, with redistribution being at the top of the economic agenda, and the generation of wealth to be redistributed is taken as given. The issue thus is *cui bono*, rather than optimal ways of multiplying asset value at the macro and micro levels alike. In the case of Latin America, where most of the literature on populism originates, this oscillated between preferring the triad of landed aristocracy, the officer corps, and the church (for the Right) contrasted to the trio of urban proletariat organized in unions, various state employees, and segments of small business (for the Left).

These policies have proven to be dead alleys, with Latin American countries secularly lagging behind in the global competition ever since World War II, largely due to these policies not refraining to fiscal and monetary legs, but extended to and complemented with overall strategies of import substitution and social engineering. It is hardly by chance that – except for the oil-rich countries of Venezuela and Bolivia – *these policies have been gradually abandoned in favor of more inclusive strategies* that rely on novel insights from the theory of economic development, including outward orientation and market reforms, with more or less success over the past three decades (Foxlex and Stallings 2016). Therefore, we omit Latin America from our models of illiberalism, as a matter of the past. Our present analysis focuses on what is perceived by its practitioners *as successful cases of illiberalism*.

Successful illiberalism, globally speaking, used to be seen as a contradiction in terms in the economic policy literature. This is no longer the case. Especially following the Great Recession of 2007–2009, the state is back. Not only do we observe more and increasingly meticulous regulation in the financial sector, but we also see the rise of the state-owned enterprise (Voszka 2017). The latter emerges not only in the more traditional way, namely as a steppingstone towards later (re-)privatization to local or foreign strategic owners. Especially in Western Europe, we observe public ownership as a lasting arrangement for firms in many sectors.

In sum, in the three decades between 1980 and 2010, there has been a secular trend towards diminishing the economic role of the state, by way of privatization and liberalization. This has been canonized in the academe, textbooks included. By the current decade, in turn, this situation has changed dramatically. Illiberalism, implying that the state intervenes not only by default, but in the name of public interest, and not only at times of crisis, but also in normal times, as a rule, *has translated into a doctrinal change*. This holds for economics, political science, and the broader policymaking motives, in advanced and emerging economies alike.

Illiberal policies differ from “orthodoxy” in a number of ways. It relies more on ad-hoc interventions, it does not follow maxims of the rule of law, no matter how laxly defined. It does not aim at even-handedness across sectors or nations, and does not necessarily respect the sanctity of private property. Illiberalism may be more openly populist or enlightened. In the latter case, broader economic considerations, such as competitiveness, wealth creation, or even equity of distribution may count among the objectives. In a way, it may follow similar aims as in the liberal mainstream, but attained on a different avenue, and by different means.

### **The Emergence of Enlightened Illiberalism**

If on the onset of economic and political transformations three decades ago received wisdom seemed uncontested, this is no longer the case. The insights informed primarily by a combination of mainstream (Chicago) economics supported in policymaking by the Thatcher-Reagan free market revolution of the 1980s. The latter eventually translated into what was called the “Washington Consensus” (Marangos 2007). The latter implies *the policy paradigm advocated* basically, though by no means exclusively, *by the international financial institutions*. The latter,

based on their experience of stabilization and structural reform policies, were advancing advice to a plethora of countries at lower levels of development, and far not only in the former Soviet Empire, about how things should be done. Following the corporate practice of benchmarking, a set of policies that revolve around financial stabilization, liberalization and not least large-scale privatization were considered to be the only right standard, against which “good practices” or “good governance” in any country should be measured.

It has always been contested, in both the academic and policy analysis contributions, whether truly and lastingly successful nations (from South Korea to Singapore) actually followed this line of thought, and if so, to what degree remaining in the background, or a kind of dependent variable (Bird, et al. 2012). To be more precise, enlightened statism has emerged. What is more relevant from our angle is the policy and doctrinal change, which occurred in the period following the Great Recession of 2007–2009. It was not only macroeconomic policies which have undergone a fundamental change, with lastingly lax fiscal stances could co-exist with lastingly super-lax monetary policies. The latter is exemplified by the renewed emphasis of the European Central Bank and the Bank of Japan (recently also of the US Federal Reserve) on quantitative easing.

This modified framework has been complemented *by a change of heart in what the policy literature considers as good governance*. As a broad overview in the latest *Handbook* (Monga and Lin 2019) illustrates, state interventionism is no longer anathema. On the contrary: state interventionism is seen as a fundamental ingredient for successful, sustainable and socially accepted, structural reforms. This is, no doubt, a sea change against what the thinking in the 1985–2007 period used to be, both in advanced and emerging economies.

Let us add what is perhaps even more intriguing for the theorist: a similar change has been observable in the academe. This does not hold for the top academic journals with their focus on abstract modelling, but all the more so in the policy literature. Ideas which counted as heterodox even a decade ago, such as acknowledging the role of specific contextual constraints for the success of good policies (Rodrik 2015), or of the role of long-term path dependence in allowing for or conversely inhibiting success of the same policy packages (Acemoglu and Robinson 2019) count by now among the bestsellers of the profession.

## History, Theory, Experience

Development economics has been, from its inception, a revolutionary subfield in the discipline, not least by laying a great emphasis on institutional factors and on policy activism by the state. This line of thought has been advocated by the most influential minds theorizing catching up (Gerschenkron, 1962). Furthermore, this has been the line of thinking of those who described East Asian developmentalism as exemplary, and by and large the refutation of classical and neoclassical economic theories (Wade 2004; Woo-Cummings 1999).

This is not the place to reiterate the ups and downs of the field. Thus, we refer to an authentic and readable summary by a single author, which is by definition coherent (unlike collective accounts tend to be). As Gérard Roland (2013) explains, developmental studies underwent a long and arduous journey, from their original, rather simple and naïve forms of copying Soviet-type planning, or adopting simple Harrod-Domar types of economic growth modelling. Both were laying one-sided and undue emphasis on physical capital accumulation in bringing about sustained growth, while neglecting systemic factors, incentives and social acceptance, let alone environmental degradation and the need to revert or preferably pre-empt it.

Import-substituting industrialization, which was the buzzword for the period from 1930 to 1980, has not always and has not primarily been informed by economic theories. In reality, *theories often generalized ongoing policy experimentation*, supplying arguments for practices in a variety of countries, from Argentina to India. These practices often followed rather pedestrian considerations, such as economic nationalism, often triggered by the downturns of the global markets, particularly in 1929–1933, during the Great Depression. Later on, planning and industrialization served as vehicles for centralized, one party rule. Further, they often embodied the driving forces of the de-colonization movements, in Asia and Africa alike in the 1950s, 1960s and 1970s.

Import-substitution tended to be seen – ever since its founding father, Friedrich List – as *an objective good on its own right*, freeing the less-developed countries from the colonial yoke. It was also meant to serve creation of an economic structure which bears the imprint of an imaginary community; the nation. Such a pattern seemed to be the guarantor of modernity, of catching up. In this way of thinking economics – unlike its classical and neoclassical brands – its focus is not about

individual welfare. It is about much higher-ranking macro objectives: about the glory and influence of the nation (often conflated with a new empire, as in Germany and Russia of the nineteenth century).

Likewise, industrialization, ever since the rise of Britain and later of Germany, was seen as a vital, indispensable element for overcoming backwardness. Thus developing, *de-colonialized and other independent, aspiring countries have been intuitively and consciously addicted to a variety of statist policies*, irrespective of their ideological orientation. Japan under the Emperor was a right-wing dictatorship, while the Soviet Union under Stalin a left-wing one. What they shared had been the negation of markets, of political pluralism and elevating statism to the rank of a secular religion, a palpable form of more abstract ideas of nationalism.

Under this angle, this is anything but surprising to observe. Economic thinking and economic practice in the vast majority of developing and emerging countries has been *state-centered, interventionist and restrictive of private property, of capital markets and of international trade*.

This observation applies to different degrees in various periods and countries. For instance, in the cases of South Korea and Singapore, private property has remained dominant over public property. Still, the state – by the proverbial “picking winners” policy – has influenced economic outcomes to a large extent, even to the level of corporations and their interconnections. For instance, the fate of such – by now global – trademarks as Samsung or Hyundai were decided by governmental decisions, not the blind forces of the market. This holds even if the intertwining between administration and corporate interest has been, until nowadays, *bene notorious*, to the point of *state capture*. The latter means that private business interest is able to influence public policy decisions to a dominant degree.

By contrast, the more *typical developing country model of 1940 to 1990 was presented by India*. Here, the limitation of private property, administrative controls of prices and of foreign trade, lack of currency convertibility, and state planning of major investment project was the rule. Moreover, not only the planning, but also implementation of these important mechanisms was in the hands of a clumsy and over-extended state bureaucracy. Public firms and close-to-government private entrepreneurs jointly shaped the outcomes, which tended to be dismal. Following the extraordinary period of state of emergency in 1975–1977, usually described as one of a police state, the infamous

Indian statism remained until the liberalization drive launched by then-finance minister (and later, in 2004 to 2014, Premier) Manmohan Singh in 1991.

This holds true, even if many preliminaries of the gradual, but sustaining reforms were conceived and in part even implemented between 1984–1989, under the Rajiv Gandhi governments (Subramanian 2008). India is often seen as an ideal type, both for its adoption planning and import substitution in the 1950–1980 period and similarly, later in terms of its gradual abandonment in favor of gradual liberalization, both of the domestic and foreign sectors. Still, the latter change was largely a concession to the power of circumstances – of changing global rules of the game – than a sincere conversion to the policies of marketization and opening.

By the late 1980s, the situation – as well as the theoretical reflection of reality – has undergone a tectonic change (Bhagwati 1998). First; import substitution had proven to be a dead end, since most developing countries are small (even if their territory and population is large, as country size is contextually measured in purchasing power). Second; industrialization has produced old-fashioned, internationally non-competitive structures, since in the post-war era servicing economies emerged, and industry started to shrink as a share of GDP. Third; innovation has increasingly become de-nationalized and globalized. Being parts of corporate networks have become the precondition to climbing up on the value chain. Fourth; the *emergence of middle classes* has not allowed planners to impose their consumer and life-style-preferences on the majority, even if migration remained restricted. Fifth; technological advancements improved the flow of information, which rendered seclusion into a non-starter. Even war crimes, from Afghanistan to Rwanda, were reported real-time. The same went for economic and business matters. Finally, contrary to its promises, statist import substitution has helped little – if any – the lot of the poorest twenty-five to thirty percent of the population. Income distribution has remained as extremely unequal as it was in colonial times.

In short, these set of insights turned the paradigm of the Washington Consensus into the only game in town (China being the exception to the general rule). The policy approach, called the Great Moderation in certain countries (Stock and Watson 2003), implied a set of understandings about *what needs to be done and how in the economy, going across various schools of economic thought*. Western countries have been successful in disinflation, in opening up their markets and keeping them open also at times of recessions. The IMF/WTO regime of open trade and finance did survive

despite occasional setbacks and counterexamples. Deregulation of commodity, labor and financial markets has happened. Privatization, though slowed, has permeated the logic of competitive markets and public corporations. In new public management, even state administration, was followed business principles. Public-private partnerships abounded in many western countries. Market regulation and the logic of the market gained upper hand. And welfare improved for many strata-less perhaps in the US then elsewhere in the OECD.

In the period between 1985 and 2008, the perspective of seeing opening up *cum* marketization – universally beneficial and particularly advantageous for the poor countries growing out of poverty (Panagariya 2019) – could also be considered mainstream in development economics. This was much less so in actual policy practice, as we shall see below. This consensus view, which was both able and willing to incorporate insights from environmental studies on sustainability (as well as the need for participatory solutions, if “right” policies are to survive electoral cycles) has by and large become the line taken by the international financial institutions (Ravallion 2016).

Confronted with the shocks of the Great Recession in 2007–2009, as well as with the erosion of the multilateral WTO regime (Baldwin 2016), the situation was also exacerbated by the unilateralist and openly protectionist line adopted by the Trump administration from the very outset of its reign, i.e. in 2016–2020. The change implied a return to *state managed trade policy options*, bilateralism and resort to “national champions,” revived from the cemetery of economic history. Importantly, this emerged in the United States, which has been the champion – and also the major beneficiary – of free and multilateral trade regimes ever since World War II. Under the Trump regime, US trade policy has become the vanguard of bilateralism and protectionism by renouncing all the major multilateral trade agreements, including TTIP, the Trans-Pacific Trade Agreement, and more recently NAFTA.

While one might speculate on the voodoo economics behind these measures, it would be hard not to see these as *formative* experiences for the more recent period, i.e., *the second decade of the current millennium*. Reviving state interventionism – including the rehabilitation and respectability of state property in areas like banking or certain other industries – can be described as a new trend in the evolution of the economic systems of advanced countries (Voszka 2018). True, nationalization often was previously just a prelude to privatization or re-privatization. Still, the role of the visible hand has become much more pronounced than ever before in various Western

economies, advanced and emerging alike (Szanyi 2020). This provides a fundamentally changed background to the growingly interventionist trends in various emerging economies, which is a trend we shall discuss below.

## **Empirical Models of State-led Development in Emerging Economies**

In the following section, we shall discuss four models which may well be considered ideal types for state-led development. This is not the whole story. Still, these models are considered, both inside and outside the countries concerned, *as successful cases contrasting to the neoliberal ideas* and practices of the Great Moderation. We disregard the African and Latin American experience. Not as if these economies were more market-oriented and less interventionist. Rather, because of the wide-spread assessment, these country groups have missed the opportunity for catching up at a time when global markets tended to be open. Moreover, the cost of external finance has reached historic lows, even preceding the current decade of lastingly negative real rates of interest. By contrast, the four models we single out are generally considered to be success stories, both by the countries/elites themselves and a significant part of the profession of international analysts.

### *The developmental state*

As can be seen from the related volumes already cited, the developmental state was a peculiar East Asian answer to the double challenge of military threat and economic backwardness. In the following, we base our argumentation on the authoritative volume (Williams 2014) which surveys empirical evidence and presents the state of art in the debates.

The developmental state is a theoretical and policy operationalization of the experience of successful industrialization in South Korea, Taiwan, Hong Kong, and Singapore. In the second wave, several countries followed suit, with considerable national peculiarities in terms of conceptualization and actual management alike. These included Malaysia, Indonesia, Thailand, the Philippines, and, more recently, post-reform Vietnam.

Recent theory and policy debates have raised the issue *if the concept can be extended to other parts of the globe*. For instance, Ireland has had periods of state activism, especially in creating new



industries. In countries like Egypt and Brazil, the state has played an active role in shaping economic structures, and often to the point of picking winners.

We tend to be cautious against over-extending the concept to all countries with activist industrial policies, let alone to state involvement in setting sectoral priorities. In the economic literature the term “industrial policy” and “structural reform” have been retained for the all-encompassing concepts, as the recent and highly authoritative *Oxford Handbook on Structural Transformation* explains in its various chapters, especially in the introduction of the editors (Monga and Lin 2019). If we find it expedient avoiding the conflation of terms and concepts, the developmental state – as distinct from activist state – remains a specific regional phenomenon, tailored to the needs and opportunities of the East Asian region.

The developmental state is thus an arrangement, built on the *pre-eminence of private property*. This means in practice the co-existence of small farms in agriculture-following the postwar land reform – with the basically large corporations in industry and finance. The cozy and intimate relationship of Korean *chaebols* and their financing banks has been proverbial. Though many reforms have taken place, especially following the financial crisis of 1997–1998 (Berger et al. 2015), the underlying structural features have hardly changed, while formal meeting of international standards have indeed increased. *Private property owners’ interest is the independent, state administration’s role increasingly the dependent variable* at times, when military rule becomes a distant memory of the past (the 1950s and 1960s).

Inside the economic system it is hard to delineate the dog from its tail, since most decisions are jointly made by banking and industrial gurus. Some are tempted to speak about the subjugation of banks to industrial interest- these are primarily American authors. Others would describe the model as a rehash of classical German-French brand of *Finanzkapitalismus*, so vividly attacked already by the early socialist movements of the nineteenth century. In the second reading, it is financial interest which prevails and picking the winners is subordinate to the latter.

Whatever interpretation we follow, it remains a matter of fact that *the emergence of new products, processes and services does not follow the Silicon Valley model of market competition and market-based finance*. While interventionism has declined and became more transparent and legalistic, the state administration’s ambitions in setting economic priorities has hardly declined. In a way, it may resemble a socialist planned economy, with two important differences. First; it is not based

on public but on private ownership. Second; bureaucracy is by no means a booty for the political class, as has been the case in much of Latin America and even more in Africa. Bureaucracy has followed the Confucian ideas and Japanese practical example of meritocracy rather than following political, loyalty-based appointments. Thus, administrations remained high performing, and of good quality, all across the political and business cycles.

The model succeeded in all four countries, with their per capita GDP exceeding mainland China by a considerable margin: Singapore \$102,027 USD, Hong Kong \$67,558 USD, South Korea \$43,212 USD, and Taiwan \$55,290 on purchasing power parity in 2019 according to IMF World Economic Outlook. This has never been the case in economic history before, with China registering a mere \$18,110 USD in the same source.

### *Russia, the mother of all illiberalism*

Since we are talking about the largest military power of Europe over the past two centuries, it is unsurprising to find a fundamentally illiberal economic model accompanying the sustaining military buildup, which has been formative across regimes and historic periods (Hedlund 2012). The long-run path dependence consideration, elaborated by the Swedish expert cited above in great detail and supported with meticulous collection of sources, data and competing interpretations, helps the observer to overcome the still prevailing surprise that Russia has never managed to become a “normal country,” as locals tended to call for during the 1990s and the first decade of the 2000s.

Russia has never been a liberal economy. In the second half of the nineteenth century, state-led industrialization was the model case for theorists (Gerschenkron 1962), even at times when private property and currency convertibility dominated the scene. Similarly, in the Soviet period, the country was the textbook model of how a command economy functions, not at least owing to the historic traditions these arrangements could build upon (and quite unlike in Central Europe, China or Vietnam). Coming closer to our times, the Yeltsin reforms did away with the party-state and also with the ruins of the planned economy. However, even those managing the process had to concede, that owing to a variety of long and short term factors, discussed by contributors to this authoritative volume expound in detail (Gaidar 2003), long term path dependence could not be

overcome. In this interpretation of Russian experts, it was not ad-hoc policy failures or imperfect institutional change, but rather the deep interconnectedness of the economic and the political, of history and contemporary policy considerations which kept Russia on the traditional track.

Re-reading the account of the insiders of that time of radical reforms is instructive also from today's perspective. It strengthens the insight that nobody is to blame for "having lost Russia." It is neither insufficient Western (mostly US) engagement, nor lack of professionalism on the side of reformers which are to blame. The very fact that they themselves came to the rediscovery of the path dependence argument speaks for itself (while bits and pieces are valuable on their own, rejecting a purely deterministic reading of events).

It is worth underlining that more recent accounts of Russian developments in the 2000s (Aslund 2019) highlight the relevance of *redistribution as well as the power considerations* in rolling back even that limited liberalization brought by the Yeltsin period in trade, finance, and especially in investments. While in abstract terms one could have argued that a centralized political structure brought about by the first Putin Presidency could have allowed for more rather than less marketization, following the Chilean or Chinese model, this has not been the case. The new model has been yet another version of the old *rentier state, or political capitalism*, adding little to new theoretical insights. The high global energy prices of the period running up to 2012 have allowed for an old-fashioned imperial policy to cement itself.

*Russia has never disengaged itself from its empire*, less the Baltic States, which became NATO members in 1999. It has sustained military presence in a variety of areas, from Tajikistan to Moldova, described euphemistically as "frozen conflicts." Ever since the 2008 Georgian war, escalating into the 2014 annexation of the Crimea, and followed by the 2018 military victory in the Syrian proxy war, Russian military power is not just a beauty spot in the life of the country. Needs of defense, perceived or real, dominate investments, and an ever-stricter state control of the economy has become normal.

The more we appreciate the conventional nationalistic view about the pre-eminence of the *gloire de la nation* over individual welfare concerns, the more successful we shall find the arrangements of the Putin Presidency. True, as long as we leave the terrain of the set of coordinates of the regime

itself and move to the more mainstream economic and political considerations (Yavlinky 2018), the less we will be inclined to see the benefits of illiberalism and the more willing to emphasize the costs this old-fashioned imperial policy inflicts over the 147 million Russian citizens. Thus, *the option is a success story for the rulers, but not for the ruled*. A GDP growth between 0.3 and 2.3 percent per annum in 2014–2019 equals to the performance of the EU average by a country where GDP per head is less than two thirds of the target region, is anything but impressive. The cost of military adventurism is particularly high at a time when shale gas production in the US and Saudi overcapacities, coupled with other major energy producers' expanding output with technological change in OECD moving towards less energy intensive models, do not bode well for a resource export dependent economy.

### *China, the everlasting exception*

China has always been a puzzle for all analysts, economists, political scientists, sociologists, and historians alike. China has a very special path of development, which not only is outside the analytical toolbox of western academic disciplines, but is hard to comprehend in those terms. Within the economy we see two basic trends. One is a move towards less command and more market, less and less private property, leading some top authorities to question if China is socialist at all (Naughton 2017). On the other hand, we have a clear retreat from liberalization ever since 2012, and the Xi Presidency is quite clear on setting severe limits not only on political but also economic decentralization, as far as it is feasible at all in such a huge and diverse economy (Du 2018; Kwong 2019).

As long as China is being compared to the classical Soviet-type command economy, the enthusiasm is hard to overcome. Measured against the standards of the 1929 to 1989 period of timid, if any, decentralization (Nove 1992), China has been making giant steps toward creating a market economy. Without re-iterating the empirics marshalled in the volumes cited in the preceding paragraph, we can clearly accept that *Communist China has moved miles away from the classical central planning model of any sort*. This has strengthened rather than weakened the leading role of the Communist Party, itself being a conglomerate of competing factions, regional, economic, and ideological convictions. Interests and perceptions naturally diverge in what is by now the largest exporting power of the globe overtaking Germany and the second largest economy

after the United States in absolute terms according to World Bank data. Also, an entity covering a sixth of humankind is – by its very nature – diverse, and can by no means be monolithic. The more governance takes into account these inevitable features the more likely it is able to address regional and also policy diversity.

Empirical studies of the Chinese economy have constantly highlighted the other side of the same coin. As insiders have never even tried to camouflage (Zhang 2014), Chinese leaders targeted and attained *decentralization without privatization*. While delegating authority to lower level organs, regional bosses, and corporate directors, has been considerable, recurring centralization, both political and organizational has limited the scope of independent decisions. Land has remained in state hands, despite the leasing system. The latter allows, both in urban and rural areas, the state to come in with its own initiative, frequently crossing the projects of local private or co-operative organizations.

Limits on the accumulation of land and its use as collateral *inherently limits the growth of truly capitalist ventures* as distinct from flea markets. Limitations of real private ventures, even their persecution – usually on grounds of profiteering and tax evasion – have never stopped. The share of truly private sector – as distinct from the so-called non-state – has been stagnant for 15 to 20 years. While the non-state sector contributes to GDP about 70%, actual private sector is estimated to run slightly over 20%, the difference accounted by township-village enterprises and other forms of semi-state ownership.

Similarly, pervasive price controls, which have never been discontinued, distort allocation decisions and limit efficiency gains from decentralization. The *lack of convertibility* of the Chinese currency, the *renminbi* puts severe limits on international trade and capital markets. The 45 to 49% investment rate observed over the past two decades is by itself *a clear indication of very low efficiency*, which is being compensated by lastingly high factor inputs and disregard for the environment. The latter has become a major theme in debates on China and its economic progress.

Without sinking into the details of Chinese economic development, it is quite easy to establish *the following duality*. On the one hand, decentralization has become considerable for standards of a Communist economy, and central organs in general and planning in particular have lost the pre-eminent positions that characterized the Soviet period and its emulation in all socialist countries. On the other hand, even a cursory look at actually existing arrangements *caution against*

*considering China a true market economy or considering its economic policies liberal* in even the laxest sense. Price controls, limits on property, limits on trade, currency controls, administrative barriers to entry and exit are formative for a tightly managed and meticulously controlled set of economic policymaking. All major investments continue to be made, or at least licensed by the political authorities on non-transparent grounds and clearly disregarding considerations of return. The traditional Communist quest for the highest output possible goes on, at the cost of quality and reliability, as recurring accidents in the construction industry, floods, and collapse of skyscrapers remind outside observers.

The moment we disregard command economy standards, we are being confronted with *a highly arbitrary, policy-driven model, where interventionism is not an exception, but a rule*. This interventionism is entirely dependent on the assessment, or good will of the authorities. True, these tend to be regional rather than central, but party control is beyond doubt and has even intensified under Xi Jinping's presidency from 2012 to 2020. Abolishing the term limits to the supreme leader in March, 2018 was, in itself, symbolic of the extreme centralization, which some may call despotic political rule, which constrains market and political decentralization alike. *Accession to the WTO in 2012 has not lead, as many hoped, for liberalization and transparency in the foreign trade and investment regime*. China counts among the least accountable and most corrupt business spots of the global economy.

China follows officially the one country-two systems model. Hong-Kong has long been one of the most liberal and most successful among emerging economies of the globe. The very fact that two decades after re-unification with the People's Republic political unrest is still on clearly indicates the limits of adaptability and tolerance of the policies of Communist China. While Hong Kong continues to enjoy a considerable edge, the changes in the People's Republic have been slowing down. Hong Kong's per capita GDP in 2017 according to World Development Indicators database was \$61,540 USD, as compared to the People's Republic \$16,807 USD in purchasing power parity.

In all, despite cultural and geographic closeness, *mainland China would be hard to qualify as one of the cases of the developmental state* as we discussed above in the current section. The role of private property, of opening and of administrative meritocracy all seem to be lacking. China joined globalization in an extremely one-sided manner, unlike the Asian Tiger economies. The regular

surplus in the trade and current account, reaching 3–8% of GNI per annum, is in itself a sign of both *mercantilist trade policies and lack of lucrative domestic investment opportunities*, in a country where consumption has been suppressed for decades, in order to finance excessively high investment rates. None of these is indicative of any variant of liberal free market policies.

*Hungary: a model of what for Central Europe?*

In over half a century following the revolution of 1956, Hungary accounted for the frontrunner in reform and later systemic transformation in the world. True, Poland has always been more liberal in political terms, still economic changes tended to be seen as pioneering for the Communist and post-communist world.

*Hungary started to lag, in terms of structural reforms, but also growth performance already in the period between 1999 and 2009, i.e., prior to the spillover of the Great Recession (Csaba 2011).* This had to do basically with two factors. First, reform radicalism of the 1990s allowed for a more lenient approach, which was in line with the return to normal politics of democratic countries, characterized by short termism, pork-barrel politics and increasing impact of media events over substantive debates. Second, the European Union experienced a period of reform fatigue and resistance to deepening projects. The latter positively invited a complacent approach in many, if not all, transition countries. Most of them made little use of the opportunities EU membership opened up for further structural reforms, if for no other reason, than for qualifying for the single currency, i.e., joining the EMU. The latter was a consensus point, for political and economic reasons alike, across the political spectrum.

The first decade of the 2000s was by and large one of drifting, rather than outright reversals. Omissions in terms of needed structural reforms, could be observed, without truly good reasons, even with governments enjoying solid majority in the legislation in 2002 to 2008. The disintegration of the left-liberal coalition gave way to a new super majority of the right in 2010. This could well have allowed, at least in the theory of economic reforms, for resolute changes for the better, *structural reforms*, as explained in the Handbook we cited above.

Reality turned out to be different. What may have seemed at the outset, i.e., in 2010 to 2012 as improvised crisis management, when the speed of the decisions was more important than their

substance (let alone coherence) a new model emerged and solidified. This state-led model of “national capitalism” has incrementally, but lastingly and substantially deviating from the more conventional social market economy of the preceding two decades, modelled on EU standards.

For those who still believe in the merits of the EU style social market economy, the second decade has proven to be one of commissions, namely *deliberate policies to move away from liberal market policies and principles* (Csaba 2019). The objective of joining the EMU was given up, and interventionism and discretionary policies became part and parcel of normalcy. Not only as prompted by exigencies of various sorts, but one of chosen policy ideal, where following non-economic priorities is not a fallacy, but a virtue.

I do not see it necessary to rehash the bits and pieces, including the broad literature review provided in the two articles cited above. In this chapter we note just the basic features, which emerged in the second decade of the 2000s, and obviously not following a secret master plan. Still, they add up into *a much more centralized or coordinated version of the market system*, than the one we could observe in 1990 to 2010. Political scientists inside and outside the country are divided if the observed changes add up to a new régime type, or if these constitute a mere lapse from one type of known model-liberal market order – into the other major type- coordinated market model – as discussed in the mainstream of Varieties of Capitalism literature.

The most important features of the illiberal model are the increased reliance of – mostly secret, only ex post known – *governmental decisions on investments, regulations and details of conduct of economic activities*. In terms of investment far the best-known example is the Paks II nuclear power plan, yet to be built, but shaping the pattern of investments and economic structures for the long run. In terms of property, the emergence of Hungarian – usually close to government – ownership of major players in banking, the energy sector and mass media should be underscored. In terms of regulation, *targeted and detailed interventionism in petty detail against the EU principles of equal treatment* – by nationality, size and sector – must be highlighted, where reasons for the type and depth of intervention is mostly unknown to outsiders. Certainly, this is by no means a Hungarian specialty. Still, it constitutes a clear break with the tendencies of the 1988 to 2010 period, which aimed at shadowing an EU – and particularly German – type of social market economy, as reflected in the stipulations of the Constitution of 1990 (but not in the Basic Law of 2011). For instance, the entry describing the Forint as the national currency renders a referendum



on introducing the Euro impossible. Furthermore, such a move would need a two-thirds majority vote in the legislation on changing the Basic Law before the decision could be promulgated. Likewise, equal treatment of foreign and local investors used to be the requirement. By contrast, “patriotic economic policies” aim at providing preferences to locals, especially in banking, the media, land ownership and retail trade, as noted above.

Given that we do have a variety of state managed versions of capitalist economies on the globe, the theoretically most intriguing question is if, and why, changes in Hungary constitute just a limited back move of the shuttle, largely in line with global tendencies (Szanyi 2020)? Or alternatively, *has step by step change turned into a different quality*, one of unilateral dependencies, which resemble more to various non-European models of political capitalism? For the broader, global picture these regressions from the more conventional German type of market model of the 1990s and 2000s deserve to be merged as equal to the Russian, Ukrainian, and Balkan models of *predatory capitalism*, aptly characterized as *mafia state* (Magyar 2016a; 2019)?

Answering this question in a truly in-depth fashion would take a separate analysis. Let me confine myself to some fundamental observations here. First, the empirics generalized in the theoretical concept of the mafia-state is rooted in Russia, usually described as a classical rentier state, which Hungary axiomatically is not. Second, Putin’s Russia, especially in the current decade, is truly seen as an autocratic polity where checks and balances have basically been abolished. This is not yet the case in Hungary. Third, Russia has traditionally been and remained a closed economy and closed society. By contrast, in the case of Hungary both exports and imports equal to GDP. No less than 600,000 people, or 15% of the economically active population, works abroad. The internet is not controlled by the state, nor is social media subservient to the state administration.

Foreign ownership has though diminished, but accounts for the larger part of economic assets in Hungary, but not in Russia. While Russia is a prime case of Orthodox Christianity, with state and church merged, Hungary has always been part of the West. Moreover, *religious pluralism* has been observable from the mid-sixteenth century (one of the first laws acknowledging freedom of convictions dates back to 1568, acknowledged by the Austrian Emperor in 1606 in the peace of Vienna). As a result, the rule of law has been an operational concept – including *ius resistendi* – and even the need for parliamentary approval of military spending has been a fact of the matter. Without much ado, Hungary has traditionally been an entirely different region of Europe (Szűcs

1983), which has operational relevance for later periods as well, especially owing to its growing middle classes and vibrant civil society.

In short, as any model should reflect *outcomes rather than intentions*, we would describe Hungary as a distinct model of illiberalism. Experiences in other Central European countries, including Italy, Latvia, or Croatia may *resemble but not become identical* to the Russian and Ukrainian model on the ground. It could be tasked to an entirely different monograph to check and prove if, any to what degree, the Hungarian practice can indeed be generalized, extended to Poland or the Czech Republic. The papers in the collection cited above (Magyar 2019) do point in that direction, but the evidence provided there is more of a snapshot. Further exceptions, as the cases of Slovakia, Slovenia, and the Baltics suggest, remain, and theoretical generalizations should be treated with a modicum of salt.

### **Speculations on the Future of Economic Illiberalism**

We have a huge body of literature by now which attempts to generalize the experience with illiberalism in economic policy, over and above the political science debate over *illiberal solutions and hybrid regimes, which seem to be lastingly workable in various countries and time periods*. In a telling example, an influential American analyst (Kurlantzik 2016) forecasted the spread of statist practices as a global trend. As we referred to it in passing, major trading powers of the globe, like China, the United States, Russia, and Japan have recently and repeatedly been involved in protectionist practices of various sorts.

One of the potential generalizations that may emerge from our overview of the four successful or enlightened models of illiberalism is that *the traditional focus on re-distribution at the expense of general rules and wealth creation remains valid*. Even in the case of China, it is high factor inputs that compensate for low efficiency of allocation of resources, and the latter follows from the political picking of winners via non-transparent bargains with local party officials, and not through capital markets. If we compare Hong Kong's GDP per capita – \$49,330 USD in 2019 – to the People's Republic of China's \$10,100 USD in the same year, the nearly fivefold difference speaks for itself, with Hong Kong being one of the regional hubs of capital market transactions of the region.

Re-distribution emerged in a number of different ways. As a rule, business close to the government administration or the governing party regularly and considerably benefit from the priorities set by public policies. This applies for as different models as the one of Kaczynski's Poland and post-crisis South Korea. The techniques employed to bring about desired outcomes may and do differ, but the final outcome is rather similar: the subordination of economic outcomes to policy priorities. In a peculiar manner, this is exactly Polanyi's perspective of "economy of society," *die Wirtschaft der Gesellschaft*, society in the models (but not in Polanyi) represented by the ruling party.

There are also, however, changes in forms of illiberalism. If the traditional model tended to focus on lax fiscal and lax monetary policies, this is no longer a feature of illiberalism. While lax fiscal policies – tolerating increases in the public debt/GDP ratios also in good times – and quantitative easing, allowing for sustaining low rates of interest, around the zero band, are features of policies of advanced countries, illiberal models tend to stick to relative fiscal and monetary orthodoxy. In none of the four cases we discussed could one observe runaway inflation or explosion of public debt, as it used to be the case in the 1960s, 1970s and 1980s.

We also may observe the role of statism in a number of different ways. National champions no longer count as exotic remnants of the past in peculiar distant atypical market economies. Likewise, the practice of limiting foreign ownership in various sectors, deemed as "strategic" is no longer an event which raises eyebrows. It was still under the Obama administration, committed to multilateralism and free trade, that the German government was induced in 2016 to limit the purchase of robotics firms by the Chinese.

At a time of growing *virtualization of the economy*, with the borderline between physical and virtual realities withering away, and also observing the over-arching spread of cybercrime, from loss of identities to direct military applications and intervention in other countries' elections, one cannot easily shrug off any government regulation as unnecessary interventionism.

However, the basics of social science should not be questioned. It is intervention rather than non-interference which needs to be justified in a market economy. *Free trade*, if basic norms are observed, has long been *welfare enhancing especially in the past four decades, and particularly in poor countries* (Panagariya 2019). Last, but not at all least, financial deepening and globalization have allowed more and better-quality finance for not only innovations, but also in industry,

services, and trade than ever before. This allows for an unprecedented increase of welfare. If distributed equitably, this is the way ahead for humankind.

*The IT revolution has long made the spread of information and thus of finance a secular, irreversible trend.* This sets certain norms for how and what policies may be effective in bringing about well-being, not just to meet political priorities of the rulers (Stiglitz 2019). For instance, capital controls, long advocated by the Keynesian school, and having gained respectability during the Great Recession, are unlikely to bite at a time when most money is being created by the commercial sector and also increasing via e-deals. *None of these are under the control of monetary authorities let alone other regulators.* If money and credit supply, thus exchange rate movements can no longer count among the basics of economic policy instruments, demand is increasingly influenced by global factors beyond the realm of policy-making, arbitrary decisions on picking winners, of rewarding and punishing players on political grounds is a rifle which is likely to backfire earlier than advocates would believe.

*Financial deepening*, which implies more and more diverse forms of financial instruments to be used by various players of the economy, is likely to increase. The more negative rates of interest count among part and parcel of the “new normal” of lax fiscal and monetary policies, *the higher is the incentive for financial innovation*, good and bad alike. One may well recall that the emergence of structured products and other bundled instruments has largely been triggered by the lastingly low rates of interest and the thus squeezed bank profits in the firms, formal, primary sector of financial intermediation. Financial innovation is known to have solved the problems at the level of the micro while *transposing them to the level of the macro*, that of the global financial system.

While global finance has never been entirely self-regulatory, its *modus operandi* does *put severe limits on arbitrary interventions*. The latter are known to produce distortions, the latter price differences, which in turn create possibilities for lucrative regulatory arbitrage. Money making then does not require innovation or more output, just a quick glimpse on the computer and on the price tags/quotations on the market. Therefore, the room for “I do it my way” policies diminish, quite apart from the ever thicker web of globally valid regulations, mostly produced by the guild rather than by regulators. This means no more and no less, than *major decisions over the allocation of scarce resources follow their own logic*. On the micro level as we discussed above, on the macro level through capital flight and “speculation.” If one considers the regular capital account of both

China and Russia, running in the range to 3–8% of GDP per annum, our claim seems to be validated without much further elaboration.

Globalization of trade has been a secular phenomenon over the past four centuries. The big debate is if it is a trigger of inequalities inside and among the countries/territorial states, and if it indeed requires and produces a larger state redistribution in more open, smaller economies, as previous theory tended to hold (Rodrik 1998). *More recent evidence contradicts this widely shared suggestion.* First, globalization, in new evidence, cannot be blamed for inequalities, with countervailing forces at work, as more recently shown in detail evidenced by one of the best scholars on inequality (Ravallion 2018).

Second, with the spread of information and communications technologies, the traditionally postulated dividing line between tradables and non-tradables is withering away. Services, for one, and so-called strategic industries (such as air traffic) have become subjects to international exchanges. Third, with the spread of e-commerce, *the dividing line becomes even more permeable*, from securities' trade to insurances, tourism, and provision of entertainment across the border. In all, the traditional view ascribing special regulatory functions to the administration in order to set individual and social priorities alike seems to become immaterial and impracticable. By that same token, one of the strongest arguments in favor of illiberalism in economic policy is withering away.

Last, but not at all least, the fourth industrial revolution brings about new challenges and new opportunities. The fourth industrial revolution, where the use of IT is becoming integral for production and sale, favors small business, innovativeness, and de-emphasizes formerly dominant economies of scale as the formative element of competitiveness (Kovács 2018). Without entering into details, this trend (joined by the previous three) obviously has been *limiting the room for any sort of picking winners*, which used to be at the heart of the East Asian developmental state model.

Provided we do not fully misread the new trends in technology, finance, and trade, the room for state-led policies is about to decrease. The secular growth of middle classes, especially in Asia, Africa, and Latin America, implies that the *room for governments to shape preferences and tastes, expectations and ways of life has been on the decrease* and this trend is likely to continue. The ongoing migration of people – and especially a largely unconstrained flow of information via social media and the internet – *limits traditional possibilities for authoritarian options in all walks of life.* Competition, coupled with the IT revolution, has long made a mockery of such previously

respectable economic notions as natural monopoly, or strictly national ways of life. As documented above, even the softer forms of the developmental state are about to be eroded, not least through the tendencies we described in a shorthand manner in this chapter, but which are supported by vast evidence in the literature cited below.

## Conclusion

This chapter presented a broad-brush view on illiberal economic policies. We have shown that illiberalism – as the traditional bedfellow of nationalism and statism – is by no means a new phenomenon in various economic systems. On the contrary: it is Anglo-Saxon capitalism, with its emphasis on the stock market as the major mechanism of macro-economic resource allocation, which has been exceptional, and state-led options of various sorts, relying on leveraged banking tended to be the rule. This holds both in time and space. Surprisingly though, *illiberal economic policies may escort the most unexpected brands of populism*. For instance, the Trump administration's protectionist, selective, and bilateralist trade policy line stands in stark contrast to the free-market approach of the Republicans in general and the stance adopted by the same administration on financial regulation in particular.

What is new about illiberal economic policies is *their revival in the post-crisis period of the second decade of the 2000s as a trend, rather than a fashion*. We were showing four models that are considered to be success stories by those employing them. We attempted at indicating their limitations *from the perspective of enhancing well-being for the majority* of the citizens of the nations concerned.

Karl Polányi (1944) argued that the disembedding of economy from society – that is, a defining feature of capitalism in its radically liberal phases – is at the root of the emerging of statism up to the point of totalitarian regimes. While he made the observation during the height of World War II, when it seemed trivial, the observation has been invoked many times later if we search for deeper roots of the return of state-led models – that is, illiberal economic policies – other than the natural move of the political shuttle. To some extent, it may hold for some countries, especially advanced economies like the United Kingdom or even the US, where leading personalities of the financial sector (Bernanke et al. 2019) have called attention to the dangers inherent in an under-

regulated system of financial intermediation, exacerbated by the deregulating moves of the Trump administration. But, as we have tried to show, this is by far not the whole story. In several countries, especially in Asia, government-led policies and social engineering do not have the bitter flavor they have in much of Europe. Enlightened illiberalism is certainly in the cards, as one of the options local conditions may favor, and not only in city states like Singapore.

Following an important trend in international studies, *we asked if illiberalism may become the dominant tendency for the decades to come*. We have listed some major, secular trends shaping global development which render it unlikely that illiberal policies may become the main avenue for successful economic development for humankind. By making this claim, we avoid presenting a forecast. As was the case with the Soviet-type command economy, or with the Argentinian or Brazilian-style import substituting industrialization, *policy models which are not necessarily efficient in the long run may sustain for decades*. This requires caution for those of us who attempt a crystal-ball gazing on what the future may harbor. Illiberalism, with or without populism, is certainly in the cards, despite well-founded economic misgivings.

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