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Chapter 1
Defining State-Capitalism

After the collapse of communism and the demise of the Soviet Union, transformation strategies for post-socialist countries were dominated by the liberal school of economic thought (e.g., Åslund, 2013). In an attempt to create a full-fledged market economy embedded in a democratic order, all the countries needed to stabilize, liberalize, and privatize their economies. In whatever timing and sequencing strategy — a controversy that was dominating the so-called *shock-versus-gradualism* debate — the ideas on the role of the state were clear. It needed to retreat from an active direction of the economy! A *third way* in which both the market and the state were to coincide was deemed obsolete.

Twenty five years of transformation experiences have shown that the landscape of emerging economic systems is quite diverse. Different policies of stabilization have been applied, as has been the case with liberalization and privatization strategies. More importantly, a revival of the role for the state has also occurred. Some have indicated that the *ruble crisis* in 1998 triggered opposition to the politics of marketization and the neo-liberal discourse of radical reform (Bönker, Müller and Pickel, 2002), but this opposition more or less remained within the margins of timing and sequencing of reforms. The idea of a small state remained more or less undisputed. The diverging responses to the global financial crisis in 2008/2009, however, did lead to new

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perspectives on the role of the state. Scholars frequently indicated that those economies, which have relied on a larger role of the state, have been more successful in addressing the social and economic consequences of the crisis. Thus, many commentators, politicians, and academics have welcomed the return of the economically active state (Kurlantzick, 2016).

This book addresses politico-economic developments in Central Asia — Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan, and also Russia — and it particularly focuses on the economic role of the state since the beginning of the transition processes in the early 1990s. Relative to Eastern European countries and other successor states of the Soviet Union, the Central Asian countries have relied more heavily on the state.[1] Even more so, given the extraordinary achievements of China as a state-capitalist country, we consider it reasonable to investigate *state-capitalism* as an emerging politico-economic order in Central Asia. Therefore, this study will not solely examine policies of stabilization, liberalization, and privatization, but also focus on politico-economic institutions that set the rules of the game (North, 1990).

In this book, we will define *state-capitalism* as official ownership and management of significant means of production, including any new enterprises introduced. The state may, e.g., control strategic industries and stock resources to assure national defense or only own minority shares in other important industries. The government appoints management personnel and decides the use of gross profits for new investments. The usual purposes of such control are to promote growth and equitable distribution and to offset market failures or externalities, such as pollution. The obvious contrast to state-capitalism is free market capitalism, where economic decisions are made by private

[1] See, e.g., Ahrens and Hoen (2013) as well as Gleason (2003), Radnitz (2010), and Pomfret (2006) for comparative discussions of political and economic developments in Central Asia after the demise of the Soviet Union. For a cultural and political history of these countries, see Hiro (2009).

individuals based on prices prevailing in their market environment. Bolsheviks such as Vladimir Lenin and Nikolai Bukharin had insisted that worker interests in state-capitalism would be represented in the "dictatorship of the proletariat," that is, in practice the Communist Party. In contrast to Soviet socialism, state-capitalism is not controlled by the working class, who earn wages, and any private owners have no obligation to social welfare.

Three Kinds of State-Capitalism

In the previous literature, the label *state-capitalism* has often been used for political and ideological purposes. Indeed, the expression originated in the debates within socialist circles at the late nineteenth century (Carver, 2011, p. 399). It is believed that the German socialist Wilhelm Liebknecht coined the term in 1896 by stating: "Nobody has combated State Socialism more than we German Socialists; nobody has shown more distinctively than I that State Socialism is really State-Capitalism" (Liebknecht, 1896, p. 4). Thus, these socialists were criticizing any economy that would exploit the workers in the interests of the state rather than private owners. Later on, however, some socialists perceived state socialism as an effective and efficient alternative to capitalism from *finance capitalism*, associated with monopolistic control by money interests.

With the retreat of communism at the end of the 1980s and the beginning of the 1990s, the term *state-capitalism* lost its currency along with *real* or *state socialism,* both terms associated with the USSR. Francis Fukuyama (1992, p. xi) expressed the idea that the end of the 1980s was "not just the end of the cold war, or the passing of a particular period of post-war history, but the end of history as such: that is, the end point of mankind's ideological evolution and the universalization of Western liberal democracy as the final form of human government." To him, the spread of successful liberal market economies throughout much of the globe appeared to render further discussion of alternative economic orders superfluous.

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But the global financial crisis of 2008/2009, slower growth in Western Europe and elsewhere, as contrasted with consistently fast and dynamic growth in China and Southeast Asia, revived state-capitalism as an attractive alternative (Bremmer, 2009). "The era of free-market triumphalism has come to a shuddering half, and the crisis that destroyed Lehman Brothers in 2008 is now engulfing much of the rich world" (*The Economist*, 2012). Thus, state-capitalism has increasingly become attractive as an alternative development model for catching-up economies.

The new literature on state-capitalism identifies different categories. Kurlantzick (2016), for example, distinguishes between "autocratic" and "democratic" as well as between "efficient" versus "inefficient" state-capitalist regimes. He identifies countries from China to Russia, from Brazil to Saudi Arabia, and from India to Singapore and eventually Norway as state-capitalist. We neglect this classification as too vague and possibly misleading because virtually all emerging markets as well as resource-rich advanced economies may qualify as state-capitalist despite significant differences regarding the role of government in their economies.

Bremmer (2010, p. 23) points out that state-capitalism "dominates markets primarily for political gain," and he adds that "most important [tools of state-capitalism; the authors] are national oil (and gas) corporations (NOCs), other state-owned enterprises (SOEs), privately owned national champions, and sovereign wealth funds (SWFs)" (Bremmer, 2010, p. 54). Refraining from day-to-day control, governments use direct and more subtle indirect tools, institutions, and measures to manage strategic sectors of the economy. They also take advantage of capitalist institutions such as stock markets and embrace globalization as long as it serves vested politico-economic interests.

Following this line of reasoning and given the fact that all countries under scrutiny in this book are *non-democratic* and can barely be called *efficient*, we identify three different types of state-capitalism in today's Eurasia: *crony* or bureaucratic capitalism in Russia and Kyrgyzstan, *dual-economy* capitalism in Kazakhstan and Uzbekistan, and what we

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will call *predatory* capitalism in Tajikistan and Turkmenistan. Although all six are authoritarian regimes with only the formalities of democracy — such as elections or parliaments — we wish to distinguish three *ideal types* (referring to Max Weber's "Gedankenbilder," i.e., mental images) to emphasize the main character of their practice and prospects.[2] The two *crony* or *kleptocratic* forms of state-capitalism began as failed market regimes. Dual-economy state-capitalism has a recognized and growing periphery of market-based businesses besides strategic sectors that support the regime. The last two regimes are essentially one-man autocracies that take their support from two main sources: taxes on the subsistence sector and international loans, remittances, or humanitarian aid. Decisions are made by the head man and his close associates, a kind of political household.

Modern-Day State-Capitalism

But what kind of politico-economic order is meant by today's "state-capitalism"? *The Economist*'s survey in 2012 contrasted this new form with *old* state-capitalism, in which the state owns and plans most of the means of production in industry, natural resources, and foreign trade. This was true of Nazi Germany and Soviet Russia, where autarky was long preferred for fear of outside exploitation (Holzman, 1987, pp. 91–109). In the Soviet Union small private plots, professional services — to the extent that they had been allowed — suffered from supply constraints (Kornai, 1980), leading to a large shadow economy. These 20th century forms did indeed embrace science in technology and management, offered free health care and education, and tolerated small businesses with limits. Besides these common policies, however, *new* state-capitalism is supposed to "meld the powers of the state

[2] In Weber's great works in comparative sociology, the ideal type is a "one-sided *accentuation*" intended to bring out certain features of a situation under a "unified *analytical* construct (*Gedankenbild*)" (Weber, 2011 [1949], p. 90); see also Weber (2013 [1922] and 2001 [1905]).

with the powers of capitalism" (Wooldridge, 2012, p. 3). As practiced in East and Southeast Asia these days, s*tate-capitalism* may embrace globalization, open trade, and funding from international financial organizations and even listing (usually minority) shares on the stock exchanges of the world. All these practices were opposed by Soviet practice and ideology under Lenin, Josef Stalin, and their successors. The older state-capitalism did *not* allow investors to pick winners and losers for investing or allow its currency to fluctuate or permit off-shoring and tax avoidance. It did not make indelible commitments to multinational corporations or international banks. The newer state-capitalism of the end of the 20th century does all these things.

Following the wartime break in their national histories, semi-authoritarian governments in post-war Japan, Park Chung Hee's South Korea, and Lee Kwan Yew's Singapore successfully adopted *state-capitalism* with *Asian values*. They created national champions, *chaebols*, or strategic industries. Those creations still exist in various new forms. They include huge state-owned companies like Japan Post Holdings, Daewoo, and Singapore Airlines. In some semi-authoritarian Asian countries with state-capitalism, officials interfere in business in ways quite distinct from the organization and behavior of the Soviet command economy (Lavigne, 1999, pp. 10–15). But planning and control are non-mandatory or looser. The central state refrains from decreeing orders regarding what, how much and for whom to produce. Parliamentary parties or other political actors exercise their role in deciding how profits are to be used. Of course, liberal capitalist countries like the USA and European states also headquarter huge multinational companies — Exxon Mobil, Unilever, and Norway's Statoil and Statkraft — but their parliamentary regimes do *not* dominate the companies' decision-making. By contrast, in the People's Republic of China, such companies, which account for 80 percent of the capitalization on the country's stock exchange, are ultimately controlled by the Chinese Communist Party. In authoritarian versions of state-capitalism, such as China and countries of the Persian Gulf, politicians have more power than they would have in semi-authoritarian or liberal

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market economies. In these authoritarian regimes, the state-capitalist system primarily serves the interest of the elites (Bremmer, 2009, p. 52). Managers and their policies often need to be approved by the ruling political parties or state holding companies. Along with this direct interference, the state may be willing to provide or guarantee cheap loans, favorable prices, or assured demand. If successfully managed, state-capitalist regimes can be politically stable if they gain legitimacy through comparatively high economic growth rates, success in international relations, and the provision of public goods to maintain acceptable social standards. Up to now, this has been the case in Russia, Kazakhstan, and Uzbekistan.[3]

In contrast to the former Soviet bloc, many of today's best performing state-owned companies are globally competitive. Many are oil or natural-gas companies selling in a worldwide market. Russia's Gazprom, e.g., is a dominant provider of Europe's natural gas. But state-owned companies also operate in the field of consumer goods such as mobile phones. New state-capitalism does not necessarily exclude private enterprises. In semi-authoritarian states, significant numbers of private enterprises coexist very well with the flourishing state-dominated sector. In today's Russia, the agricultural sector is market-oriented with little interference; it exports grain and imports many vegetable and fruit products from abroad. In China, private and even foreign firms may benefit from intercourse with booming state-owned companies, as well as corrupt local officials.

Shortcomings of State-Capitalism

Despite the fact that state-capitalism has been praised for its economic success, it is important to emphasize the drawbacks that may impede the sustainability of the system. From the point of view of material advance, state-capitalism has been successful in catching up with the

[3] See, e.g., the contributions in Brusis *et al.* (2016) as well as in Ahrens and Hoen (2013).

most developed parts of the world. Hence, state-driven growth is often found in transition economies and in less developed countries, but it usually fails in nurturing innovation, as we shall see (*The Economist*, 2012, pp. 9–10). Kurlantzick (2016) points out that modern state-capitalism can, however, be very competitive and is able to compete with private multinationals. For Central Asia, however, we question this argument, because this hybrid economic order is vulnerable to rent seeking, corruption and cronyism (Åslund, 2007, pp. 47–53). This hinders private-sector creativity and individual initiative. In addition, such a regime discriminates against the non-privileged sectors of the economy and thereby possibly increases income and asset disparities. From a political point of view, there is doubt whether a population currently experiencing increasing prosperity will be willing indefinitely to accept benefits flowing disproportionately to small political elites (Bremmer, 2009, p. 53). Hence, one may expect growing acceptance issues in the population which might imply political instabilities in the course of time, especially if a state-capitalist regime lacks public capacities to implement policies effectively.

What is Dual-Economy Capitalism?

In a dual-economy form of state-capitalism, which we explore here in the cases of Kazakhstan and Uzbekistan, there is a state-driven, modern and export-oriented core sector, which coexists with a smaller, usually less advanced private sector. The term *dual economy* was coined by Julius Herman Boeke (1953), a Dutch academic and civil servant who applied the term to the Dutch-Indies, an economy and a society then divided between the traditional hinterland and the modern sectors in which the Dutch colonial capitalists operated.[4] As later discovered, the concept of a dual-economy applied well to production and business

[4]After finishing his doctorate in 1910, Boeke left the Netherlands and committed himself to help modernizing the Dutch colony. In 1919, he returned home after his appointment as one of the first professors in *tropical-colonial economics*, an early form of development economics.

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structures that existed in a number of developing countries. Almost all were characterized by their asymmetry and rigidity into two separate and distinct sectors within one country.

Previous models of the dual economy posited an advanced manufacturing sector organized oriented to the world market, along with a deprived rural sector relying on the traditional methods of production and distribution. The most famous early example of a dual-economy approach came from W. Arthur Lewis and his followers, Fei and Ranis (1964). Lewis theorized that "capitalist" sectors of poor countries could draw on unlimited supplies of labor from the "backward" non-capitalist or "subsistence" sectors (Lewis, 1954). These countries were typically overpopulated, he thought, so the incremental contribution of agricultural labor approached zero. Therefore, surplus labor could be released to urban industries without reducing agricultural output. While in standard economic theory, earnings are determined by the value of a worker's *marginal* productivity (Gylfason, 1999, pp. 26–28), in the Lewis' model, rural laborers receive customary subsistence derived from *average* productivity of the group or village. The salience of group or village interests is one feature of many primitive or backward societies, alone with strong religious or magical beliefs. Indeed, average incomes in rural areas would eventually rise owing to gradual emigration of low-productivity members to the cities or abroad, while industrial wages would remain stable, allowing profits for new investments. The idea of conventional consumption norms divorced from marginal productivity in village agriculture was radically different from neoclassical models thought to characterize all sectors, even of poor countries. The Lewis model would, however, be of little use to present-day understanding of most Eurasian economies. Their inhabitants' adoption of material values and more individualism make it more reasonable to assume rational (i.e., material utility maximizing) behavior in all parts of post-Soviet society. For the purposes of applying a dual-economy approach to state-capitalist Central Asian countries, according to our observations, one would also have to modify the notion of *backwardness* because most union republics of the USSR, including Uzbekistan and Kazakhstan, had experienced considerable urbanization,

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secularization, and industrialization (Nove and Newth, 1967). In Kyrgyzstan, Tajikistan, and Turkmenistan, urbanized capital districts are also clearly most affected by secular motivations.

In dual-economy types of state-capitalism, according to our approach, emphasis is on how different organizational structures may suit the conditions of each sector. In state-capitalist countries, the *peripheral* firms may be petty capitalist, though often using modern technology, but are regulated by local market forces. Strong competition and prices, rather than personal ties, become the key coordination mechanisms and incentives. In the *core*, on the other hand, patronage and political advantage are the common motivation. Though set by the state, the structures, regulations, and interventions regarding both core and periphery must suit the interests of elites without compromising the interests of the broad population too much lest inconvenient protests arise. Especially in favorable times of globalization, internationally exposed and competitive core industries can not only benefit vested interests but also the overall economy through spillover and diffusion effects. For example, wireless communication and computerized banking affect all businesses, not just those in the core. State-owned companies often operate in the field of consumer goods, e.g., providing mobile phones.

How do state officials treat businesses in these three sectors — with or without limits on their authority? How do they affect the allocation of essential factors of production, such as land and communications? In crony capitalism, managers of many firms must clear their key decisions with the bureaucracy. The state runs vital monopoly sectors, such as pipelines, railways, and arms production. In dual-economy types, only prominent enterprises are affected by direct orders. Because the country's international position is involved, military and strategic sectors must remain part of the core of the economy (Little, 1982, p. 95). Rigidity is sometimes featured in the theories of a dual-economy (Jorgenson, 1961). If so, the existence of different sectors is perceived as an obstacle for sustainable economic growth. With the exception of taxing, political considerations do not prevail in the periphery. Indeed,

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an informal sector — which exists in all state-capitalist types — tries and often succeeds in evading taxes altogether. In *parasitic* economies, such as Turkmenistan and Tajikistan, the leader in the capital simply skims off most of the profit from the leading export or other convertible currency source without much involvement in how production is accomplished. In these parasitic economies, the leader makes household decisions about his spending and that of his close supporters, leaving the majority of the country to its own, usually subsistence and barter provision. He also tries to dip into any funds remitted by returning citizens, loans or grants from international agencies or donors. This could be royalties from a facility run by foreigners on a concession. That means incentives of the elite are political instead of purely economic; position in the regime must be a prime consideration. Price, profit, and tax considerations are secondary in what is produced and for whom.

One purpose of this research on state-capitalism is to try to perceive any source of change in the specific forms of state-capitalism in Eurasia. For example, in the dual economies of Central Asia, are there any signs of an increasing *seeping through* between the state-dominant core and the non-state-dominated periphery when market conditions for energy exports deteriorate, as they did in 2014–2016? In case there are inter-sectoral flows, duality could possibly be seen as merely transitional, rather than as an inherent, long-lasting failure in the modernization of the two respective countries. Whether or not a given duality persists over time depends on the country-specific governance structures. What would be the effect on transition policies when the authoritarian leaders of Kazakhstan or Uzbekistan pass from the scene? Are the other leaders in danger of removal when outside conditions change? To the extent that the existing leadership structure decays because of its institutional imperfections, we may see country-specific institutions which serve as functional equivalents of the past structures (Ahrens, 2011). But no economic system lasts forever.