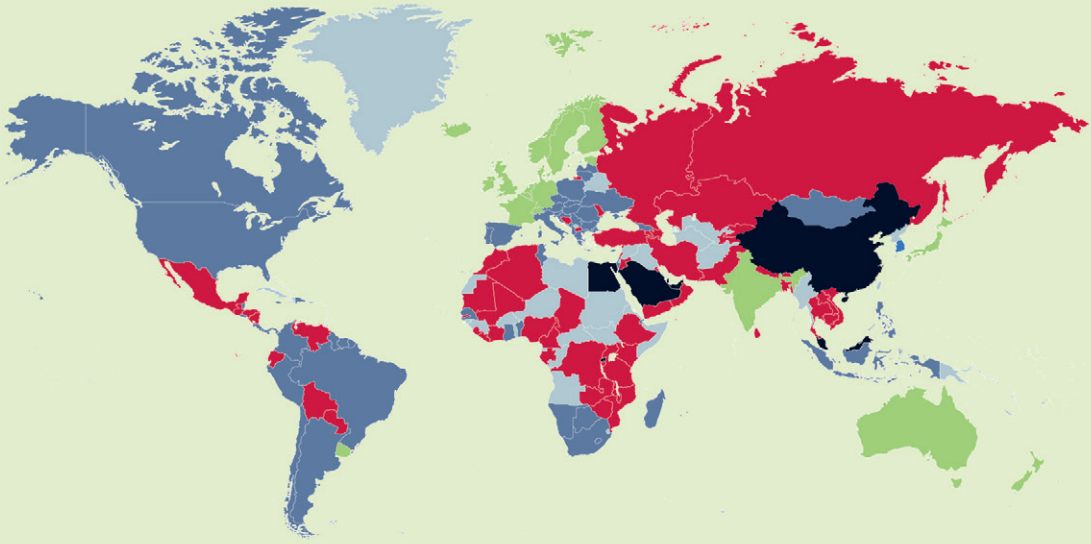
THE GROWTH PATHS OF STATE-SOCIETY RELATIONS

Power Dynamics, Industrial Policy, and the Pursuit of Inclusive and Sustainable Growth



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The Growth Paths of State-Society Relations: Power Dynamics, Industrial Policy, and the Pursuit of Inclusive and Sustainable Growth

BY

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To my lovely son Jonas (Yunis) who colored life with joy!

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Dr Sabry's academic fields of interests are Institutional Economics, Economic Development, Political Economy, and the Middle East and North Africa (MENA) region, and the focus of his research is on state–society relations, state–business relations, and industrial policy. He published several books in English and Arabic and several academic papers in different peer-reviewed journals.

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Introduction

At the eve of 2022, the world was yearning for the turn of the mighty tide that had bore the most severe economic and social crisis from which no country almost escaped. The widely successful global vaccination campaigns and the emergence of less fatal variants of COVID-19 spread optimism about economic recovery. Post-crisis high economic growth rates would bring with it more employment and the resumption of the accelerating Green transformation 8 years away of the set milestones of 2030. It was just less than 2 months after, however, when Russian troops did what had been feared and pushed through Ukrainian defenses on the 24th of February. The world is now watching the consequences without a clue about the end scene. As the West and Russia keep trying to corner each other while avoiding hitting a direct blow, the long suppressed horror of nuclear global warfare keeps resurfacing. Yet, something else is more certain and keeps enforcing itself everywhere. A new current of economic crisis is merging with the subsiding COVID-19 not long-ago mighty tide. No longer are discussions about a recession but rather about the worst economic nightmare, a supply shock-induced stagflation.

Major crises are more often times for big changes. Out of the great devastation, human loss, and economic fiasco of the First World War emerged the first European and to some extent global socialist wave. Out of the Great Depression (1928–1933) came the inspiring and challenging ideas of Keynesianism but also a mighty and disturbing wave of Fascism. The end of the Second World War, the by far the most socially and economically destructive event of the twentieth century, brought postwar Statism, postcolonial liberation movements, structuralism, welfare states, and many other trends. Then the stagflation of the 1970s swept away many of these trends, instating a neoliberal paradigm that made its way to the twenty-first century and survived yet two major financial crises toward the end of the twentieth century and at the end of the first decade of the millennium.

The present set of interweaving crises, however, represents a much greater challenge. Besides the COVID-19 and the Russian-Ukrainian War, a major global trade confrontation between the USA and China is looming on the horizon, with the emergence of potential major allies for either sides being so likely. Environmental catastrophes are increasing in pace, causing major and

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irredeemable social and economic losses. History points out to us that this might be a major turning point.

There is a growing realization that an exclusive focus on economic growth is improper. Neither is a growth path that seeks inclusive growth sufficient. Rather, the objective is ever more identified as achieving a more sustainable and inclusive growth. The reorientation toward such a new objective invites rethinking of strategies and national priorities and reconsideration of what is anticipated as economic success or which countries could be labeled "economic miracles."

The issue of how to distribute the fruits of economic growth was a major concern of the twentieth century, fueling the rise of political movements and economic schools of thought that called for more equitable distribution within and among nations. Most of the century witnessed multifaceted fierce ideological conflicts in which capitalism was challenged by leftist movements ranging from central left social democrats to radical communist movements and passing by populist and leftist nationalist variants. These movements managed at different points of time to control much of the globe and force an agenda of a more equitable distribution of income and wealth, even at the perceived strongholds of capitalism.

In the twenty-first century, the acceleration of environmental threats – from extreme heat waves and major droughts to tsunamis and floods – and the accompanying social awareness brought more attention toward sustainability. Similar to the previous century with regard to inequality, political movements and a growing literature evolved and gained ever increasing popularity for its defense for a more Green economy and putting breaks on environmental degradation. Green parties have increasingly been part of the ruling coalitions in many European countries since the 1990s and environmental civil society organizations and protest movements have spread all over the globe. Sustainable development had been integrated to the United Nations (UN) Millennium Development Goals at the turn of the twenty-first century and then more emphasis on environmental issues were put in its successor, the sustainable development goals (SDGs) announced in the second decade of the century. Environmental sustainability became an important pillar in the growth path of countries, developed or developing alike.

In their pursuit to sustainable and inclusive growth, countries went to different paths with varying degrees of success in realizing the three, often contradictory objectives: economic growth, equality, and environmental sustainability. There is a growing realization that a higher economic growth is not sustainable in the long run if environmental issues are not taken into consideration, and that the environment on the domestic and global scale will avenge its violators and, actually, everyone on the globe. A similar realization was reached earlier by many who came to the conclusion that following a growth path characterized by high inequality of distribution would result in extremely high social and political costs; these costs would ultimately threaten of major social conflict that will jeopardize the whole path and the society itself. Nevertheless, existing structures and entrenched interests often prevent restructuring of the economy and the political

economic order in a way that targets a more balanced growth path that accounts for the three stated growth path dimensions.

Central to the different growth paths taken by various countries is their institutional settings that could be supportive or otherwise to realizing better and more balanced paths. Important are regulations, legislations, laws, or simply policies that guide performance toward realizing sustainable and inclusive growth. With the industrial sector and especially manufacturing occupying a special position in the modern economy since the First Industrial Revolution in the eighteenth century, industrial policy has a special position in such debate. The interest in industrial policy was renewed in the years following the financial crisis of the late 2000s. Such an interest coincided with growing doubts concerning the ability of market mechanisms and *laissez-faire* government to restore the economy, target the right sectors, and fix the existing structural and regional imbalances (see Aghion et al., 2011; Warwick, 2013). With an even greater economic crisis looming on the horizon following the COVID-19 pandemic and the Russian-Ukranian War, further growing interest in industrial policy is anticipated. The pressing need to boost innovation, upgrade technology, and increase productivity is growing into a worldwide concern that calls for government intervention. Ecological hazards have increasingly become a concern that led to global action and international summits that discussed and reached major international agreements such as the Paris Climate Accords of 2015. Economic crises and environmental catastrophes also usually hit the marginalized and poor more than others. Inequality, which has been globally increasing in the last decades, could be further aggravated. Social unrest, revolutions, radicalism, and the rise of populism in many countries of the world – whether developed or developing – point to the need for policies that aim for equality and sustainability as they aim for long-run economic growth.

While the interest in industrial policy is more often found in developing countries supported by arguments on economic catching-up, the developed world is also increasingly sharing such interest. The COVID-19 crisis heated the discussion that has been running for more than a decade in the developed world. The growing interest in the developed world on industrial development, or "re-industrialization," went beyond academic debate and knew its way to government policies and strategies. The Fourth Industrial Revolution (Industry 4.0) – with its focus on digital production technologies, management processes based on information technology (IT), and new materials – promises more flexibility, efficiency, and limited labor-cost component. Such benefits encourage the reshoring of manufacturing activities to the developed world (Kinkel, 2020; Kinkel et al., 2020; Pegoraro et al., 2020). Moreover, the de-industrialization in manufacturing increased the developed world vulnerability to external shocks and harmed their economic diversity (Pegoraro et al., 2020, p. 155). Investing in manufacturing activities is sought as a strategy that addresses such shortcomings. The reshoring process is now a reality, especially for US and to a lesser degree EU firms. The USA is increasingly encouraging such a development to create more jobs (Kinkel et al., 2020). The reindustrialization of the advanced economies seems to reverse the decades-long de-industrialization process that marginalized the sector to the

benefit of the presently-dominant service sector. More importantly, reindustrialization brings back the new-old debates on how to boost industrial innovation and productivity, as well as how atomization and the new technologies could lead to loss of jobs and harm equality of distribution to the favor of capital owners. Resorting to industrial policy then seems inevitable.

Industry 4.0 also offers chances for the Greening of the economy through, for instance, the rationalization in the use of resources. Other Green innovations and technological breakthroughs put more pressure for major economic structural transformation. More, Green jobs are created, yet certainly many jobs in the old nongreen sectors and industrial activities are lost. This key transformation of the twenty-first century could hardly proceed without supportive policies. The need to foster Green innovation and technology adoption, sectoral restructuring, labor retraining, and others brings industrial policy back to the forefront and with it the usual actors that mostly shape and benefit or lose from it – businesspeople and workers.

Industrial policies that are in place in different countries obviously led to different outcomes, raising questions on the effectiveness and more importantly actual implementation and enforcement. The enactment, implementation, and enforcement of different policy profiles point to deeper institutional variables in search for explanations for the witnessed variations among countries. It is not hard to realize that state-society relations lay at the core of institutional settings responsible for policies and the resulting growth paths. In our contemporary world, industrialization is led by various state-society arrangements with varying degrees of success in achieving the envisaged objectives. Investigating state-society relations should lay at the center of any trial to understand and predict the growth path of industrialization, in the past and present alike. This does not only apply to developing countries that still struggle to proceed in their path to economically catch up with the advanced world, but also to the developed world that discovers the way to maximize its benefit from the Fourth Industrial Revolution. State-society relations guide industrial policy choices, ultimately leading to different economic outcomes related to the industrial sector, affecting its growth, efficiency, and competitiveness on one hand, and its sustainability and the distribution of its yields on the other. State-society arrangements vary between more balanced and/or collaborative means in reaching policy-consensus among state and nonstate actors to the most extreme case where the state dominates society and policy formulation. Between the two, other forms exist in which some nonstate players are more powerful than others, at times, even more than the state.

While governments often formalize policies to realize higher economic growth and sustainability and less inequality, implementation is often a different story. Existing institutions shape the behavior of the government as they affect various actors, their interaction, and, ultimately, the outcomes of these interactions. In this regard, three main actors in the industrial sector could be identified: the state, businesspeople, and labor. State-society relations governing the interactions between the three could be called state-business-labor relations (SBLR). These relations shape policies, regulations, legislations, and the degree of their enforcement, leading to a unique industrial policy profile for each country,

although common thread lines could be detected between these profiles. The resulting industrial policy then leads to different growth paths.

SBLR, as the core of state-society relations, are governed by power dynamics among the major actors. A more precise investigation leads to identifying four instead of three actors. These include again the state and labor; yet businesspeople could be differentiated into tycoons (big enterprises' businesspeople) and entrepreneurs (small and medium enterprises' businesspeople). Different SBLR *modes* emerge as a result of the power dynamics governing the interaction between these four actors. Two main dimensions determine the resultant SBLR mode: (a) the relative power of the state vis-à-vis nonstate actors and (b) tycoons' ability to secure favorite allocation of resources to their favor and at the expense of other nonstate actors. Depending on these considerations, four main SBLR modes are identified: balanced, state-capture, crony, and state-dominance. The balanced mode is characterized, as its name suggests, by a more balanced power allocation between all state and social actors without having a dominant actor. The state-capture mode, agreeing with the literature, is one characterized by more dominant tycoons, even vis-à-vis the state. Also, the definition of the crony mode agrees with the literature in characterizing it with the presence of a dominant state, subservient but favored tycoons, and less powerful entrepreneurs and labor. Finally, the state-dominance mode is characterized by a highly dominant state with less powerful social actors, including tycoons who do not enjoy much favorite treatment.

This book contributes to a topic that deserves more attention in the literature. It depends on the literature on institutional economics, state-business relations, industrial relations, and corporatism to construct its theoretical framework. More specifically, the SBLR framework dwells on the following bodies of literature. The first is the literature on varieties of capitalism (VoC). This literature differentiates between countries according to the way various actors coordinate their actions, categorizing developed countries into coordinated market economies (CME) and liberal market economies (LME) (Hall & Soskice, 2001; Hall & Thelen, 2009; Martin, 2005). Another important body of literature is that on state-business relations (SBR). It differentiates between formal (e.g., public–private dialogs – PPD) and informal (e.g., family or political connections) relations connecting state officials and businesspeople and how these relation forms affect economic outcomes (Enderwick, 2005; Haggard et al., 1997; Hausmann & Rodrik, 2003). A third relevant body of literature is the one on industrial relations (Glassner & Keune, 2012; Hayter, 2018; Streeck, 2009), and especially the pluralist perspective that accepts the presence of conflict between businesspeople and labor but believes in the possibility of containing it, for instance, by collective bargaining (Hayter, 2018, pp. 3–4). Little effort has been done to integrate these bodies of literature in order to build a more comprehensive understanding of the dynamics of state-society relations and their economic consequences.

The SBLR framework depends on the above-highlighted bodies of literature. It differentiates between tycoons and the rest of businesspeople, an important distinction that often goes unnoticed. It is proposed in this book that the effect on growth paths goes beyond the simple dichotomy between CMEs and LMEs

usually present in the literature of VoC and that power relations provide an essential dimension in explaining this causality. Arguably, the economic outcomes of higher coordination when the different actors have a balanced power relation would not be the same as when one actor, such as tycoons, is more dominant than other actors. Such power relations would affect government strategies, policies, and regulations which will ultimately affect various economic outcomes. In other words, inter-actors power relations should be considered even when investigating how levels of coordination between these actors affect economic outcomes.

The SBLR framework is likewise different from the literature on politically connected firms, which examines favoritism based on state-business connections (Bertrand et al., 2018; Cheng, 2018; Faccio, 2006; Fisman, 2001). This literature often depends on detecting state-business informal connections through combining firm ownership data with information obtained from experts or other sources on the social and/or political connections between firm owners and state officials. This is then used in checking the relation between connections and firms' economic performance using the financial statements of the studied firms. The methodology used in this book is rather more macro-oriented. The book stresses that favoritism can be obtained by ways other than informal connections, and therefore, power relations represent a broader analytical category explaining differential outcomes on growth, equality of distribution, and sustainability.

The research done in this book depends heavily on indicators provided by international organizations, such as the World Economic Forum and the World Bank. The key variables in identifying different SBLR settings are ones which depend on expert surveys. While these indicators are often criticized for different empirical reasons, they are still the best available in the literature. Using them to identify cross-country differences are still, arguably, superior to categorizing countries based on simple subjective assessment or pure theoretical arguments. By combining theory and statistics, one hopes that the margin of error is being minimized. Nevertheless, this is not to rule out the need to treat the judgment done here with some caution given the problems that might be present in the used indicators and other possible methodological shortcomings.

Despite the use of many statistical and mathematical methods throughout the book, the results are presented in a simpler and more engaging form to facilitate its readability. More complex details on the used methods and how results are obtained are documented either as endnotes or at the appendix.

The book first starts with a theoretical perspective part. Chapter 1 introduces the SBLR framework. The main actors in this relations are identified as the state, tycoons, entrepreneurs, and labor, with each of these actors having distinctive interests and different sources and allocation of power. According to these power dynamics, a number of distinctive SBLR modes are introduced. Added to the well-known modes of state capture and crony relations that are often discussed in the political economy literature, the further modes of state dominance and balanced modes are introduced. A new methodology is used to categorize different countries into these four main four modes and estimate the degree of the presence of these modes' characteristics in the countries of these modes.

Chapter 2 then investigates the different historical political-economic, geographical, legal, and cultural factors responsible for the emergence of these different SBLR modes. These factors affect the power dynamics within SBLR, especially by influencing the relative power of the state vis-à-vis the social actors and the degree of favoritism tycoons enjoy at the expense of the other social actors, as an indicator of their relative power.

Chapter 3 investigates how SBLR direct industrial policy. It explores how power dynamics within SBLR lead to formulating and implementing different industrial policies that have an effect on inclusive and sustainable growth. The presence of conflict of interests between social actors is highlighted, together with an explanation of how such conflict is translated into different industrial policy profiles in the different SBLR modes. A special focus is given on three important policy fields of relevance to the growth paths: technological, welfare, and Green policies. The discussion is supported by the results of game theoretical and regression models, investigating the gains of the various social players from different policy fields.

In Chapter 4, the growth paths are presented in terms of economic growth, equality, and environmental sustainability. The mechanism by which SBLR lead to different growth paths, through influencing industrial policies, is explored. The chapter wraps up the theoretical perspective part of the book by linking up the chain of causality that flows from SBLR to industrial policies to growth paths. The discussion in the chapter is aided again by game theoretical and regression models.

The second part of the book presents short case studies for each of the four SBLR modes, with the biggest economies of the world being selected: the USA, China, Germany, and Russia, each of which represents the biggest economy in its mode. Chapter 5 is an opening chapter for this part of the book. It presents a comparative statistical analysis of the four countries in terms of indicators reflecting the power dynamics governing their SBLR, the policies being enacted and implemented, and their growth paths in terms of sustainable and inclusive growth.

Chapter 6 presents the first case study, Germany, as a representative of the Balanced SBLR mode. With its historically powerful trade unions and business associations continuously engaged in tripartite negotiations with the state, the country represents a model of SBLR where balanced-power dynamics govern the interaction between the different actors. Less room is available for either the state or tycoons to be too powerful. These power dynamics shape industrial policies in the technology, welfare, and Green policy fields. The outcome is a growth path that is also more balanced, promising of more sustainable and equitable long-term growth.

SBLR in the USA are presented in Chapter 7 as an example of relations in the State-Capture mode. Despite the existing freedom of association rights and entrenched democratic institutions, social actors and especially labor unions fail to have sufficient organizational power to challenge the dominant tycoons who have various means to accessing the political system and influencing policy-makers. The effect of these settings is reflected in some biased policies in the same

identified three fields and on an unbalanced growth path that sacrifice equality and sustainability for the sake of securing long-run economic growth.

Russia in the first two decades of the twenty-first century is presented in Chapter 8 as a country where the Crony SBLR mode is evident. The tide that reversed course at the turn of the century reinstituted state power at the expense of the previously dominant tycoons who accepted a more subservient position to the new master at the Kremlin. With social actors' independent organizational power continuing to be weak as inherited from the Soviet era, the more dominant state directed industrial policies free-handedly but had to balance the privileges obtained by its favored tycoons by protecting labor rights, aided by generous flows of petrol revenue. Even if long-run growth and sustainability were not promising, a more equal distribution of resources characterized the Russian growth path.

Finally, Chapter 9 presents China as a representative of the State-Dominance mode. The state that inherited the dominance of a communist regime and the weakness of the social actors was the most capable of formulating industrial policies without much societal pressures or putting much weight for social actors' interests. The resulting growth path had relatively little potential for long-run growth, but this potential has been dynamic with improving long-run growth prospective but worsening environmental sustainability.