

Do the Surrogate States Deliver?

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While recently reviewing a paper on “Industrial Civilization,” which was presented in a webinar at the Pakistan Institute of Development Economics (PIDE), I came across the concept of a Surrogate State—a state that can deliver in terms of transition to industrial civilization, as was advised in the paper. Surrogate State was described as a state, which would possess key characteristics of a state, but would exercise a monopoly over power, politics, and ideology of the society. Alternatively, through monopoly in political power, the Surrogate State would be able to design, construct, and make operative modern political institutions. With a hierarchical structure and an authoritarian constitution, the Surrogate State is presumed to introduce administrative, legal, and economic reforms that are deemed essential for transforming an old agrarian order into a modern industrial society. It might include institutions like a standing army, bureaucracy, courts and codified laws, public systems of education and health etc. After the establishment of foundational institutions, the Surrogate State would invest in building the stock of human and physical capital as the industrial mode of production requires a certain level of capital. Onwards, the Surrogate State would take lead in establishing state-owned enterprises (SOEs) to ignite the process of industrialization on a massive scale. Further, after the phase of state-led industrialization, the reforms would have to focus on the expansion of economic activities led by the private sector. The private sector flourishes on the opportunities created by the state in terms of educated, trained, and disciplined workforce, availability of energy and basic infrastructure, raw material from primary industries, stable political environment, and policy support and all of these would be ensured by the surrogate state. Finally, after the society is caught up with the West, the surrogate state would ensure autonomy to constituent parts of the meritocracy. These constituent estates might be a standing army, civil bureaucracy, private corporations, intelligentsia, and citizens. Each of these would have to be made increasingly autonomous to keep the system efficient. However, the conflicting demands of various estates would have to be mediated by the surrogate state itself.

While, based on evidence from failed and successful countries, the idea of a surrogate state is much more eloquent in the delineation of a general sequence through which a pre-modern agricultural society would have to pass to join the ranks of modern industrialized societies. However, the sequence raises several questions as far as a detailed account of the failure stories in the rest of the countries is concerned. For instance, with regard to the Soviet Union, there was an authoritarian state very much like the “surrogate state” but it could not deliver on a sustainable basis as in the end, it ended up enhancing its absolute power instead of extending the inclusive set of institutions to individuals and the private sector. Though the Soviet Union experienced rapid economic growth in the beginning the lack of open markets providing knowledge and incentives to channel economic activities led to colossal economic inefficiencies. In other words, by adopting existing technologies rather than developing their own, especially those driven by Schumpeterian Creative Destruction, the Soviet Union failed to foster the type of environment that leads to further technological innovation and economic prosperity. To put it differently, the Soviet Union could not

transform its initial state-led industrialization into incentives-based industrialization which has put a permanent dent in its transition to an industrial civilization. Egypt, Argentina and many other developing countries in today's World, including Pakistan, are additional instances which have been strongly characterized by surrogacy or authoritarianism in state relationships but have been economic disasters.

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In sharp contrast, China's industrial revolution, which started 35 years ago, is perhaps one of the most important economic and geopolitical phenomena since the original Industrial Revolution 250 years ago. Unlike the Soviet's aggressive approach, China's approach to economic reforms was humble, gradualist, and experimental. After ensuring political stability, China's reforms focused on grassroots, starting with agriculture, promoting rural industries with their existing primitive technologies, and using manufactured goods instead of natural resources to exchange for machinery. In addition to providing enormous support in infrastructure buildup, the state focused on a structure of joint ownership instead of across-the-board privatization. With state-private ownership, China moved up the industrial ladder, from light to heavy industries, from labour- to capital-intensive production, from manufacturing to financial capitalism, and from a high-saving state to a consumeristic welfare state. In fact, China applied the true spirit of capitalism by employing the approach of "shake hands and do business" instead of ideology, religion, culture or national boundary. It is precisely such a spirit through which China has created modern industrial civilization and will continue to change the world. Japan and the Asian Tigers (South Korea, Taiwan, Hong Kong, and Singapore) are other instances which got industrialized quickly by applying similar spirits as that of China. Above all, the time is not very far when the World would witness countries like Malaysia, India, Vietnam and Bangladesh ending up in industrial civilizations.

Why, compared to the surrogate state, is the incentives-led private sector or Schumpeterian Creative Destruction more important for the transition to industrial civilization? I would like to posit that private incentives or private sector-led growth resolve two fundamental economic problems. First is the knowledge problem that arises when the decision-makers in a Surrogate State don't have sufficient knowledge of the market mechanism. For instance, in centralized decision-making, the policy officials cannot understand the fluctuations in the economies or in the operations of markets as private businesses can. The consequences are usually badly designed and misplaced priorities with regard to industrialization which, in turn, cause rent-seeking and regulatory abuse as has been evidenced in Pakistan in its post-1960s erroneous industrial policy and onwards nationalization policy in the 1970s. Similar to the knowledge problem is the incentives problem which arises when the incentives of the policymakers are not aligned with the incentives of successful industrialization. Just like other policy packages, industrialization creates opportunities for corruption and rent-seeking and, accordingly, policymakers will use these opportunities for either their self-interest or for the benefit of their relatives and friends. This kin-based structure usually causes cronyism or crony capitalism which again is not in accordance with the true spirit of capitalistic structure that is deemed as an essential ingredient of modern industrial society.

Thus, the state-led industrialization at the initial stage has been successful in China, Japan and the Asian Tigers, but it got failed in other developing countries like Pakistan. In fact, this divergence is explained by the successful transformation of state-led industrialization to

private sector-driven industrialization which has been the only sustainable structure in capitalism. So, what do the developing countries need to do to catch up with the club of industrialized countries? A simple answer is that developing countries need a regulatory state instead of somewhat an authoritarianism-based surrogate state. In such a state, the role of constituent estates like political order, army, courts and codified laws, civil bureaucracy needs to be supportive; otherwise, corruption, rent-seeking, and abusive regulatory behaviour would be the consequences as have been witnessed in most of the developing countries. In other words, private incentives should be the primary instrument of wealth creation, innovative activities and economic prosperity. A corollary to this point is that the state must be Mancur Olson's stationary bandit instead of a roving bandit where its interests are more encompassing in pursuing growth-gearred policies. Alternatively, the state must focus on the share of the wealth created by economic agents as taxes, as a revenue-maximizing state would do, and this option is more profitable to the state than grabbing the extant wealth and fleeing.

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