Tormented births: passages to modernity in Europe and the Middle East
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Chapter 8

The Political Economy of State Capitalism

Almost fifty years have passed since the establishment of the étatist regimes in the Mashreq. The Kemalist experience of interventionism is almost seventy-five years old. And this work has tried to show that the main processes that led to the collapse of the ancien regimes and the rise of statist ones are basically the same as those which the present-day industrialized countries had undergone during their passage to modernity. A valid- and obvious – question that should be addressed then is why haven’t these countries developed social, political, economic and cultural structures and practices comparable to those that Western Europe had established half a century after embarking on their modernization projects? After all, France in the 1840s and Germany in the 1910s were undergoing rapid economic growth, democratization of their political systems were going apace, their civil societies were firmly couched on the principles of individuality and their socio-cultural and political practices were mainly conducted under the banners of modern ideologies1.

In this chapter I will try to address this question by analyzing the dynamics of state capitalism in the third world in general and the Middle East in particular. Because this system flourished in many parts of the third world during the cold war era, there were very few attempts at understanding the exact working of étatism: its conditions, contradictions and the causes of its breakdown2. The cold war era did present a favorable atmosphere for the rise and consolidation of these regimes for two reasons: one is that it was mostly an era of world economic prosperity (the 1950s and 1960s in particular) which allowed for greater demand for third world products and services. Second, the competition between the two erstwhile conflicting and relatively prosperous camps allowed the transfer of large amounts of easy financial flows to the underdeveloped countries.

It would be erroneous, however, to deduce from the above that the state capitalist regimes were the simple products of an exogenous situation. Two arguments can be advanced to substantiate this claim. One is that although state interventionism was made possible by the greater availability of resources to governments in this era, not all third world countries embarked on a state capitalist path. Second, although the drive to statistism was facilitated by the overall international atmosphere, the rise and collapse of these regimes in each particular case was never an automatic reflection of that atmosphere.

Turkey’s interventionist programs began long before the cold war. Ironically, its switching to liberalization coincided with the beginning of the cold war (Okyar 1975,

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1 Moreover, contemporary cases of successful industrialization, notably South Korea and Taiwan, began from lower levels of development than the Mashreq and achieved their modernization in less than half a century.

2 We should single out the works of two Polish economists who dedicated much of their work to the dynamics of state-led economies. These are Oscar Lange (1970) and Michael Kalecki (1972).
Berberoglu 1979). The life cycle of Egypt's state capitalism began around 1956 and ended during the heyday of the Soviet power and the cold war in 1971 (Ghunaim 1986).

I will argue that one cannot understand the present socio-economic configuration of the Middle East by merely pointing out to the international factors that influenced the domestic and regional paths of evolution/devolution. I would especially want to emphasize the fact that neither the rise of state capitalist structures has been the product of "the successes of the Soviet model" as was habitually assumed in the 1960s and 1970s, nor is its demise the product of the trend toward liberalization that has swept the world since the 1980s. These factors did indeed facilitate the policy choices of third world leaders. Yet, I will try to show that the social forces that motivated states to play an intensive role in the economy of the Middle East are similar to those that put many of today's industrialized countries on this path.

8.1 A Model of State Capitalism:

Using simplified mathematical relations, I will show why third world state capitalisms were inherently unstable regimes, or transitional by nature. A system is said to be stable if it can systematically reproduce the relationships between its component elements over time. Thus the stability of a system does not necessitate the stability of its components, but the relative stability of the relationships between and among its structures and components. State capitalism, however, has an inherent tendency to divert resources to private hands (which is not necessarily capital in the strict sense of the word), and therefore it paves the road for economic liberalization irrespective of the intentions of its political leaders.

As in any model, we will only deal with the essential and basic relationships that distinguish state capitalism from other types of statist, precapitalist, or capitalist systems. The underlying assumption is that the studied system maximizes its potential for efficient functioning. Hence, we will consider the widely associated phenomena of cronyism, nepotism and corruption as distorting or 'non-essential' elements, although one can argue convincingly that these phenomena are the direct consequences of the existence of a large and unaccountable state bureaucracy that disposes of a substantial sum of a nation's wealth. The aim is to show that even under 'ideal' conditions, these regimes are inherently unstable and that those 'distorting' factors, which many consider as the major causes for the breakdown of the 'socialist' project, act only as accelerators of already existing trends.

As a working definition for state capitalist regimes, let's define them as those third world countries that adopt a policy aimed at expanding state ownership of the major means of production and finance via nationalizing foreign and domestic private institutions, without in the meantime targeting the principle of private ownership per se. In this system, the state owns and controls what it considers 'strategic sectors' in the economy; mainly banking and insurance, public transport and telecommunications.

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3 The manifestations of these 'distorting' phenomena and their implications for the formation of dominant classes in the Mashreq will be studied in more detail in the next chapter.
foreign trade, the biggest and most vital industrial establishments and extractive industry. The guiding principles behind these policies are almost always some variant of non-Marxist, nationalist socialism: Arab socialism, African socialism, etc. This definition excludes the ex-socialist countries, which aimed at abolishing private activity altogether. It also excludes these third world regimes whose reform policies did not go beyond the implementation of agrarian reforms and/or which increased the share of the state sector by using their resources to establish state-run projects.

According to this definition, less than twenty countries in the third world have had a state capitalist regime at one point or another between the 1950s and the 1980s. Soviet terminology labeled these countries 'non-capitalist' or 'socialist oriented'. By the mid-1970s, the countries that fitted within this category and the years in which they embarked on their state capitalist path were: Egypt 1956 - 1960, Guinea 1960, Burma 1961, Algeria 1962, Syria 1963, Tanzania 1961 -1967, The Republic of Congo (Brazzaville) 1969, Democratic (South) Yemen 1969, Somalia 1969, and Iraq 1970 - 1972. Later on Benin, Guinea Bissau, Mozambique and Angola would qualify to enter this club (Ulyanovsky and Pavlov 1973, Ulyanovsky 1974 and Solodovnikov and Bogoslavsky 1975).

This type of 'mixed economy' differed from the advanced capitalist welfare state in that state ownership of the means of production was not only confined to services or losing projects but it aimed at turning the state into the largest entrepreneur in the economy, running what was supposed to be profit reaping projects, while it differed from the 'socialist' model in that it did allow private economic activity in agriculture, manufacturing, construction and transport, retail (and sometimes wholesale) trade, tourism, and services. Moreover, the leaders of these regimes have always asserted that this combination of a mixed economy was to be the permanent and optimal system for their countries, assuring efficiency, social justice and development.

8.1.1 Basic Hypotheses:

We can now proceed to illustrate the mixed economy as composed of only two sectors¹: private and state-owned. Each one of these two sectors has a production cycle, revenues and costs. The relationship between these two sectors (which we can temporarily think of as two establishments) can take one of the following three forms:

1) The state sector increases its rate of capital accumulation via taxing the private sector, and/or by increasing the productivity of its units. This increased accumulation is achieved on the expense of the private sector, since taxes will be levied on the profits of the latter. Thus, assuming an equal capital/output ratio in both sectors, the state sector will tend to increase its share in the country's GDP with time.

¹ I am deliberately using the terms 'state sector' and 'public sector' interchangeably because the latter contains an ideological connotation, which implies that the state necessarily represents public interests and therefore that state projects are run on behalf of the people.
2) The private sector, benefiting from state subsidies and income transfers to it, increases its rate of accumulation, thus increasing its share of the GDP over time.

3) Each sector receives external resources (taxes for the state and subsidies for the private sector) that are equal to the revenues transferred from it. The net amount of external resource flows will be zero and both sectors only depend on their relative efficiency in order to increase their shares in the GDP.

In the following paragraphs, I will try to examine the feasibility of the third form of relationship, in order to see whether the state capitalist system can preserve its state of equilibrium in the medium term, as it is clear that only in the third case, one can assume that this system's difficulties emanate from external factors. In keeping up with the actual record of such regimes, we will not consider cases where governments rely periodically or suddenly on extra-economic measures in order to alter the relationship between the two sectors, for the experiences of state capitalist regimes show that they launch their nationalization/confiscation programs at one or two stages only.

The state sector has two outlets for disposing of its revenues, investments and public expenditure (consumption). Thus:

\[ Y_g - C_g - K_g \]  

where:

\( Y_g \) = Total Government Income
\( C_g \) = Total Public Expenditure
\( K_g \) = Annual net public investment

Statistically, we can show that \( C_g \) is an exogenous variable; i.e. it is not determined by the other variables in equation (1). Actually, government consumption (non-investment budget) tends to expand over time, and in the case of third world countries, governments tend to satisfy the consumptive needs first (salaries, subsidies), leaving the residue to investment purposes (within constraints that will be discussed below). In line with the findings of several authors (Thorn 1967:19-55, Reynolds 1971:550), government consumption will be treated as a function of first: the size of the population, since the services required from the state, as well as the size of the administrative apparatus has to do with this factor; second, the size of the urban population because it has been empirically shown that this section of the population consumes a larger proportion of the public services; third, the level of unemployment since the state is generally regarded as responsible for finding jobs or providing some financial support for them; and fourth, the national income of the country. Therefore:

\[ C_g = f(N, N_u, N_e, Y_o) \]  

\( N \) = Size of the population
\( N_u \) = Size of the urban population
\( N_e \) = Number of Unemployed
\( Y_o \) = National Income

The above mentioned variables seem to present a better explanation for the determinants of government consumption than those relations which link the latter to the consumption of the previous year, an 'explanation' that we find in the Wharton model for
the US economy (Friedman et al. 1975) and adopted by others (for example, Heller 1975: 429-446). It is true that, from a pure statistical point of view, the time-series equation can give better results because policy makers base their planning on last year’s budgets, but this is far from presenting an explanation of the level of consumption.

We have chosen the consumption, and not the investment expenditure of the state as the determining variable because governments have always tended to satisfy their consumption needs first, a fact that explains the perpetual rise in the ‘ordinary budget’ over time, while investment could decrease or increase according to the state’s available revenues in a given year. Only in exceptional cases do governments lower consumption expenditure. This is the reason why no explicit explanatory equation is needed for the government’s investment expenditure, for we will treat this variable as a mere residual from equation (1).

Since we are dealing here with $K_g$, i.e. the net additions to the capital stock or net investments without considering the investment expenditure that is required to account for depreciation in the capital stock of the public sector, then one can stipulate that there is a minimum required amount of investment, say to keep the level of capital stock at its present state. Let us assume that $K_g$ must be a positive value. Therefore, when such exceptional conditions arise when the government’s revenues cannot meet the demands for the ordinary rise in its consumption budget in addition to this minimum investment, it will have to borrow.

8.1.2 State Investment and Revenues:

We can proceed now to breakdown state investment into its component parts to see how each of these affects the relationship between the two sectors. We have noted above that unlike the ex-socialist countries, state capitalist systems allowed private activities— even encouraged them— with varying degrees. Thus part of public investment will be directed to spheres from which only the private sector would benefit. For example, while agriculture has remained predominantly in private hands, only the state was capable of investing in the construction of dams, canals and major irrigation projects. This portion, which we will denote $K_a$, is a net deduction from the state sector’s potential for capital accumulation.

A second component represents the necessary investments required for the functioning of the services provided by the consumption budget; e.g. hospitals, schools, government offices… etc. This portion we will denote by $K_s$. Although this part is provided for from the government development (investment) budgets, functionally it is part of the consumption process, as it does not yield returns. Therefore, we will call this component and the government consumption together, $C_g^*$: government consumption is the wide sense. Thus:

$$C_g^* = C_g - K_s$$

(3)

The third and last component of net government investment is that directed at yielding returns exclusively for the state sector itself. These sectors should not be seen as identical to the materially productive investment as they include storage and transport facilities, in addition to manufacturing, power and water production, etc…. We will
denotes this last component by \( K_m \). So the definition equation of the government investment is:

\[ K_e - K_i - K_o + K_m \]  (4)

What are the sources of government revenue? They come from two channels:

1) the earnings from the state-owned projects, which for the sake of simplicity will be called ‘productive projects’; \( Y_m \). This will be defined by the following equation:

\[ Y_m = \left( Y_m / K_m \right) K_m r_m K_m \]  (5)

(Note: the dot is a multiplication sign)

Where \( Y_m / K_m = \) the output-capital coefficient of the productive public sector, which will be denoted by \( r_m \) as in equation (5).

2) The second source of revenues for the state sector is the net flow of direct and indirect taxes levied from the private sector minus the opposite flow of subsidies from the state to the private sector. Here, we will not deal with the taxes levied on the state sector itself because they are only transfers within the same ‘accumulation fund’; i.e. that of the public sector itself. Thus the amount that could be levied from the private sector is obviously a function of the latter’s income such that it has to be a positive ratio. By denoting the private sector’s income \( Y_p \), and the respective tax ratios of the private and state sector \( g_1 \) and \( g_2 \), the total government income from taxes \( T \) will be:

\[ T = g_1 Y_p + g_2 Y_m \]  (6)

where: \( 0 < g_1, g_2 < 1 \)

The total government’s revenue \( Y_e \) is:

\[ Y_e = Y_m + T + g_2 Y_m \]  (7)

By substitution in equations (5) and (6), we get:

\[ Y_e = r_m K_m + g_1 Y_p \]

### 8.1.3 Private Sector’s Income:

The private sector confines its activities to profit rending branches. Hence our classification of its activities will be based on the degree of their response to, or dependence on the state sector. We will, therefore, distinguish three components of the private sector. The first, mainly in agriculture, derives its income from investments carried by the state, in addition to its own investments. Therefore:

\[ Y_o = r_a (K_o + K_{pa}) \]  (8)

Where:

\( Y_o = \) Private sector’s profits from these branches

\( K_{pa} = \) The capital stock of the private sector in these branches

\( r_a = \) productivity of capital (output/capital ratio) in these branches

Note here that we used the capital stock and not the net investments, because the yield is not a function of, say, last year’s investments, but of the availability of dams built over several past years, and so on.

The second component of the private sector is those branches dependent solely on its own investments. Thus:

\[ Y_f = r_f K_f \]  (9)
The third and last component is that income derived directly from activities done for the state sector. The starkest example (in Egypt and Iraq mainly) is the construction contracts sector, which was responsible for state, as well as private, construction. Distinguishing these dynamic types of private activities (which also include catering, transport, crafts and industries that satisfy government's demand) is of particular importance for the understanding of the life cycle of state capitalism, because although the cost of their capital and labor inputs are derived from their own resources, they have a highly elastic supply of their services. Hence they can easily respond to any change in the demand of the state or the private sector due to rising investment levels.

This means that accumulation in this sector is directly proportional to any growth in the role and size of the state sector. This should show very clearly the difference between state capitalist regimes and the ex-socialist model where the growth of capitalism in the former is complementary with the growth of the state sector, while in the latter the relationship is inverse. As the state sector is a buyer of fixed capital, each of its investment units must contribute a certain proportion to the income of the private contracts' sector. Assuming a perfect elasticity of supply of this sector's services and products, its income will be a linear function of investments by both the state and the private sector (including house building). But since our model is not concerned with income transfers within each of the private or state sector, we will only define the inter-sectoral transfers, which will take the following form:

\[ Y_k = \text{net private sector's income from activities performed for the state sector} \]
\[ k = \text{ratio (coefficient) of private sector's earnings from each monetary unit of state's expenditure/investment} \]

Now we can formulate the total income of the private sector as follows:

\[ Y_p = Y_o + Y_i \]

and the private disposable income \( Y_p^* \) (taxes deducted):

\[ Y_p^* = (Y_o + Y_i) - g\tau Y_p \]

8.1.4 Intersectoral Interaction:

We have seen that each of the state and private sectors does not function in isolation of each other. There are flows of resources in both directions: flows from the state in the form of subsidies, investment that yields income to the private sector and purchasing products and services from the private sector, while the opposite flows are mainly in the form of taxes on the private sector.

With this in mind and trying to keep as close as possible to the actual performance of state capitalism as defined above, two possible sets of expenditure relation between the two sectors will not be considered below. First, that state sector investments generate incomes exclusively to the private sector (the British, American models of industrialization). Second, that investment by the state sector generates revenues only to that sector (the theoretical concept of socialist models as perceived by Preobrazhensky) (Preobrazhensky 1965). On the revenues side we can discard two other possibilities. One, that the state sector relies entirely on the private sector for financing its investment. Two, that the state depends exclusively on its own resources for investment, since in our model
(and actually), we have assumed that part of the private sector's income is paid to the state as taxes.

We can proceed now to answer the following question: *can the state capitalist formation be inherently stable?* According to our model state capitalism is a formation in which the state sector's activities add to the accumulation fund of the private sector, bring revenues to the state itself while state revenues depend on both the private and state sectors. Thus the mathematical conditions for its stability is when the total net flows from the state sector to the private sector is zero; i.e. when it can regain the flows of resources by inflows from the private sector. Note that this condition does not necessary imply a leading role for the state sector, because that would require creating a disequilibrium situation in which the state receives more resources than it hands out. The stability condition is simply an equilibrium between the two sectors where the subsequent development of each will depend solely on the relative efficiency of each in generating a process of enlarged reproduction within.

We can determine the resources that the private sector reaps from the state by substituting equations (8), (9) and (10) in equation (11):

\[ Y_p = r_a(K_a, K_{po}) k K_g r_f K_f \]

Since \( K_a \) represents all the capital stock which the state has invested over time plus the net new investment, which we will denote by \( a K_g \), then the total capital in this sector (agriculture being the main example) is:

\[ K_a - K_{po} \quad a K_g - K_{po} \quad K_a(t) \quad K_{po} \]

Let's call the last two terms in the equation \( K_i \), then:

\[ K_a - K_{po} \quad a K_g - K_i \]

Now the private sector's revenues will be determined by the following equation:

\[ Y_p = r_a(K_a - K_i) k K_g r_f K_f \]

Now the marginal gain for the private sector derived from the investing one monetary unit by the state is:

\[ Y_{p/} K_g r_a a k \]

This means that under *uteres paribus* conditions, the private sector reaps incomes that are directly proportional to the marginal revenues of the contracts sector from state investments and also proportional to the yield of state investments in sectors like agriculture.

### 8.1.5 Taxes:

For the sake of simplifying our analysis, let's assume that the taxes imposed on the private sector are homogenenous; i.e. that the same ratios of taxes to income \( (g_i) \) are imposed on all kinds of private profits. As we have distinguished two types of private sector incomes: those derived from state investments, and incomes derived from its own investments, then we have to distinguish two kinds of tax effects. Taxes on the first group of private activities represents repayment of part of the costs incurred by the state due to its investment, while taxes levied on the second group of activities represent a net
deduction from the private sector’s revenues. Taxes on the first group, which we will call \( g_1 Y_p \) and on the second \( g_2 Y_p \), compose the total taxes levied on the private sector \( g_1 Y_p \):

\[
g_1 Y_p \quad g_1 (r_a \quad a \quad K_o \quad k \quad K_k) \quad g_1 K_o (r_a \quad a \quad k)
\]

\[
\text{(13)}
\]

Obviously, tax rates cannot reach 100%, but will be a positive constant: \( 0 \leq g < 1 \). Thus, the losses incurred by the state due to its investments for the benefit of the private sector will be:

\[
a K_o \quad K_k \quad g_1 Y_p \quad K_o (a \quad k) \quad g_1 K_o (r_a \quad a \quad k)
\]

Now we have in addition, the taxes that we considered as net deduction from the revenues of the private sector and these can be defined as follows:

\[
g_2 Y_p \quad g_2 (r_o \quad r_o K_o \quad K_o) \quad g_2 (r_o \quad a \quad k)
\]

\[
\text{(14)}
\]

Therefore, in order that the state’s resources should not be depleted to the benefit of the private sector, \( g_1 Y_p \) must be greater than the losses incurred by the state due to its unrepaid costs of investment by \( g_2 Y_p \). (Greater and not equal because there is another component that we will deal with below). But even if this were to happen; i.e. that the private sector would repay all the costs of investments, it will not be sufficient to put both sectors on an equal competitive position, because state expenditure is not confined to investment. In fact, the bulk of state expenditure, even under the auspices of the ‘developmental’ state capitalism, goes to non development expenditure, or to spheres that do not directly yield returns: schooling, hospitals, roads, electricity and water project, in addition to the traditional services of any state: policing, property protection and justice.

Thus, in order that we reach a situation where each sector carries a process of enlarged reproduction depending on its own resources, we have to break down public consumption in the wide sense \((C_k^*)\) in accordance with the above definition of its function as a flow of incomes from which the whole economy benefits. For it is only logical to assume that building a road, or raising the working force productivity through schooling and medical care will not only benefit the state sector but the private sector as well.

To simplify our mathematical reasoning, we will suppose that each sector will make benefits from this kind of state expenditure, proportionately with its share in the national income. For example, if the private sector’s share in the national income is 60%, we will assume that 60% of the costs of building a road are, in fact, incurred by the state to the benefit of the former, or in other words that the state has subsidized the private sector with a flow of resources, which in an equilibrium situation should be returned back. The private sector appropriates the following proportion from public expenditure:

\[
c \quad C_k^* \quad (Y_p \quad Y_c \quad Y_p) \quad C_k^* \quad \text{.........................}(15)
\]

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Now in order that the private sector ‘repays’ its share for the external resources that it receives from the state, the amount of taxes must be:

\[ g_{s}Y_{m} \quad (Y_{m}/Y_{m} \quad Y_{f}) \quad C_{g}^{*} \] 

(15a)

With this last operation, we have not only introduced a distinction between the state sector and the private one, but have separated the traditional ‘government sector’ (according to the national accounts terminology) from what has been traditionally called ‘the public sector’. Thus we have now an intermediary between the two sectors, providing services to both and expecting to receive the costs of these services from each. As for the private and public sectors properly speaking (those producing marketable goods and services), they interact via the investments provided by the latter to the former, the incomes transferred to it, as well as the revenues it receives from the private sector for its services. Now, the equilibrium between the two sectors will be achieved by satisfying the following condition:

\[ g_{s}Y_{p} \quad c \quad C_{g}^{*} \quad K_{g}(a \quad K) \]

But we have seen from equation (13) that the private branches depending on the state’s investments return only a fraction of their incomes to the state in the form of taxes, which means that in order that the equilibrium is preserved, the whole private sector must compensate for that difference from the returns on its own investments, i.e.:

\[ g_{s}Y_{p} \quad c \quad C_{g}^{*} \quad K_{g}(a \quad K) \quad g_{s}Y_{p} \]

Obviously, taxes are levied proportionately with the incomes, and the increase in agricultural incomes, for example, is necessarily less than the value of investments in that field, since a 100% return on capital is inconceivable. This leaves the private sector with one of two options: to repay the costs of state investment over a longer period plus the profits yielded by this investment in the form of interest rate, or to buy the assets (dams, irrigation canals, etc.) immediately. In both cases, the private sector would pay the same amount in the form of taxes. Now let’s assume that the state invests a constant amount in these branches annually. According to our equilibrium hypothesis, the private sector will have to pay the due interest rates (in a geometric series), in addition to the share due on this year’s investments (which is a \( K_{g} \)). Therefore:

\[ k \quad K_{g} \quad a \quad K_{g} \quad k \quad K_{g} \quad r_{o} \quad a \quad K_{g} \quad g_{s}Y_{p} \]

From the above we get:

\[ g_{s}Y_{p} / g_{s}Y_{p} \quad g(Y_{f} \quad Y_{o} \quad a \quad K_{g}) / g(Y_{f} \quad Y_{o} \quad a \quad K_{g}) \]

Here we assumed that the tax rates are uniform on the incomes of all branches of the private sector. Actually, the quotient of the above equation must be greater than one because all the evidence shows that public consumption (in the broad or strict senses) is much larger than the income of the contracts sector and the public investment in agriculture.
Suppose that the productivity coefficient of agricultural capital is 0.2; i.e. that the returns would cover the costs of investments in 5 years (a highly optimistic assumption), and that the tax rate on private incomes is 0.3 (also an unrealistically high assumption). In this case, \( g_3 Y_p \) will only compensate 30% of the contracts income and 6% of the public investment in agriculture, which means that \( g_4 Y_p \) will have to pay all the private sector's benefits from public consumption, in addition to 94% of the public investment in agriculture and 70% of the contracts incomes. For this condition to materialize without recourse to extra-economic policies by the state, the relative size of the private sector in the economy must be so overwhelming that one cannot characterize the model as a state capitalist one anymore, because part of the income to be compensated is a function of the state's investment.

Hence we see that state capitalism is only a transitional system that has no inherent stabilization mechanisms. For in order to keep the balance between the two forms of property, the state would have to follow one or more of the following policies:

a) levying discriminatory taxes on some branches of the private sector in order to get its flows of resources back. But that would be tantamount to a nationalization policy because it will eventually lead to the bankruptcy of these branches; 2) diminishing the state's dependence on the private sector, so that \( k \) would approach zero. through state ownership of agriculture and state reliance on its own capacities and firms for construction and other such activities, a policy that will make the system a Soviet type one; 3) supporting more growth of the private sector, since taxes are a function of income, and in this way trying to pump back more of its lost resources, a policy that will eventually diminish the role of the state in the economy and turn the latter into a privately dominated system.

But before making our final conclusions regarding the state capitalist 'mechanisms', we have to investigate the dynamics of private sector accumulation via the policy of salaries and wages, to which we should turn now.

### 8.1.6 Salaries and Wages:

Until now we have dealt with incomes or revenues as undifferentiated sums that are available for accumulation, without distinguishing between what is reinvested and what is utilized for the payment of wages and salaries. The importance of introducing the distinction between wages/salaries and profits lies in the fact that the wage policy in each of the two sectors will greatly effect the relative weight of each of them in the economy in the medium term as we will try to show below.

The available resources for accumulation in each of the two sectors depend, of course, on the level of wages and salaries paid by each of them. For the state, however, there is an additional drain which draws resources in the form of wages and salaries without, in the meantime, contributing directly to the production of marketable goods and sources: the government service sector. All wages and salaries, no matter what their sources are, will go into the private income sphere. But suppose parts of the private sector's salaries were available to accumulation, when high executive salaries are not entirely consumed for example. This will only be an internal transfer of resources within the same sector, and hence it has no effect on the working of our model. This is not the case with the state sector, as high-level or influential bureaucrats will use the incremental
incomes that surpass their consumption needs for investment in private branches. That is why we need to determine this effect on the balance between the two sectors.

Assume that the total salaries and wages paid by the state \( (W_g) \) compose a fixed ratio \( (W_3) \) of its total consumption budget:

\[
W_g = w_3C_g
\tag{16}
\]

Similarly, the wages and salaries in the private and ‘productive’ public sectors will be:

\[
W_p = w_1Y_p \tag{16a}
\]

\[
W_m = w_2Y_m \tag{16b}
\]

It is clear that the disposable income of the private sector will increase by the total wages and salaries paid by all sectors. For the public sector, the available resources for accumulation will decrease by the value of \( (16b) \). Now if all these wages go for the satisfaction of consumption needs of the employees and workers, this will not add to the potential for accumulation in the private sector (except by boosting demand on goods and services which we will not deal with here). But, when the level of wages and salaries in the state sector \( (Y_m) \) exceeds the level of consumption then the state sector will provide an additional source of accumulation for the private sector.

This is the case even if the average amount of salaries is not very high, and when there is a large income differential between the upper and lower echelons of the state bureaucracy. In fact, a high \( (w_2Y_m) \) means either that the number of state employees is very high relative to the stock of capital available within the state sector (disguised unemployment), which in turn signifies a low labor productivity and thus a reduced level of resources available for accumulation (or a low level of the organic composition of capital), or that there are high incomes which exceed the ‘marginal productivity’ of those high-income employees. These additional incomes will eventually flow into the private capital accumulation fund. As was mentioned above, a rise in the average salary or wage beyond the level of consumption in the private sector will not affect the overall potential for accumulation within this sector since this will be reinvested in the private sector itself. It will have, however, a redistribution effect within that sector whose implications have no relevance for our model.

We noted earlier that the salaries and wages of those working in the government non-marketable sector should be financed proportionately by both sectors. Thus the public sector’s share of that budget, which will flow eventually to the private expenditure sphere, should be \( Y_mW_g/Y_m + Y_p \).

Let’s call the available revenues for accumulation in the private and public sectors respectively: \( Y_p^* \) and \( Y_m^* \), then:

\[
Y_p^* = Y_p(1 - g_1) (W_m - W_g) \tag{17}
\]

\[
Y_m^* = Y_m(1 - g_2) W_m \tag{18}
\]

Or, by substitution in equation \( (16b) \):

\[
Y_m^* = Y_m^*(1 - g_2 - w_2)
\]
Where $C_p = \text{total private consumption}$

Note that equation (17) did not isolate the wages paid by the private sector because this makes no difference as long as the private consumption expenditure will be subtracted from the disposable income. Now equation (17) can be modified to become:

\[
Y_p^* Y_m^* (1 \ g_1 \ w_1) (W_m \ W_g \ W_p) C_p ...........(17a)
\]

From this last equation we can see that excessive salaries (and benefits) to upper bureaucrats constitute an additional source of private accumulation under state capitalism as a positive value of $(W_p+W_m+W_g-C_p)$ means that part of the salaries has found its way to private investment. It would be more accurate to say that when $(W_m+W_g)$ exceeds the levels required to satisfy consumption demand, a leakage from the public sector’s cycle to the private sector will occur. But we must remember that a leakage from $W_m$ will not have the same effect on the private sector’s accumulation as that of $W_g$, since we have assumed that both the private and public sectors will contribute to the finance of government expenditure (including, naturally, its wage bill) according to the contribution of each of them in the national income.

Thus a rise in the wage bill of the government consumption expenditure will only represent the public sector’s contribution to financing this bill, while an increase in $W_m$ over the consumption level will comprise a net addition to the private accumulation on the expense of the public sector’s potential for accumulation. While in the first case, that of a rise in $W_g$, the private sector will retrieve part of the taxes that it had already paid to finance the public consumption.

8.1.7 Taxes on Wages and Salaries:

What if the government imposes taxes on salaries and wages in order to offset the effects of leaking resources to the private sector and to compensate for part of the required contribution of the private sector to public consumption, as well as the state’s investments that benefit the private sector?

We will assume here that a uniform rate of taxes ($z$) is imposed on all wages and salaries. The private sector will then retrieve portions of its potential revenues for accumulation, such that equation (18) will be:

\[
Y_m^* Y_m^*(1 \ g_1 \ w_1 \ Zw_1)
\]

Taxes on private incomes ($ZW_p$) will represent a net transfer to the funds of the state sector if it is imposed alongside $g_1$. But we have already treated $g_1$ as the maximum ratio that can be imposed on private capital, which includes the taxes on its salary and wage earners. Hence $ZW_p$ can be viewed in fact as a counterflow from the waged and salaried in the private sector that contributes to the accumulation of “their” capitalists.

Thus the taxes on salaries and wages will decrease the costs that the public and private sectors incur in order to finance public expenditure to a degree proportional to the
contribution of each in the national income. But since it is \( g_1 \) that contributes to cover the public consumption, then we can consider all wage and salary taxes as additional incomes to the state sector. Thus the effect of such a tax on the balance between the two sectors will be negligible, but it will have an impact on the internal working of each of the two sectors, because as parts of \( g_1 \) and \( g_2 \), it will alleviate some pressure on profits and ensure the contribution of the salaried and workers in financing state expenditure.

8.1.8 State Sector’s Price Policy:

We can proceed now to derive the growth equations of both the private and public sectors, since the disposable income for accumulation has been determined by equations (17) and (18), and the taxes on wages and salaries were included in \( (g_1 \) and \( g_2 \)): the overall taxes imposed on both sectors. Therefore, if we make one last assumption whereby the consumption of entrepreneurs or capitalists is included in the wages and salaries items, then a simple formula relating the growth of each sector to investments and the productivity of capital will follow:

\[
\begin{align*}
Y_m &= r_m Y_m^* = r_m Y_m (1 - g_2 w_2) \\
Y_p &= r_p Y_p^* = r_p Y_p (1 - g_1 w_1) (W_m W_e W_n) C_p
\end{align*}
\]

The last variable that we will introduce to see the possibilities of shifting the balance between the two sectors under state capitalism is the price policy of the public sector, since the available income for accumulation \( (Y^*) \) is not only determined by the physical volume of production but also by the price of the produced goods and services, and by the marginal cost of production.

Relying on the actual experience of state capitalist regimes, we have seen that the public sector’s favorite branches are manufacturing, transport, power and telecommunication. Now suppose that the state decides, for whatever motives, to sell a portion of its products (especially in the last three branches) at prices below the marginal cost of their production. That portion will be bought by the public sector itself, the private sector and the wage and salary earners. Now let’s assume, for a while, that under such a system the state has the power to force the private sector to lower the prices of its products in such a way as to offset its benefit from the decrease in the prices of the public sector, and in the meantime, it has the power to keep the levels of wages and salaries such that none of these will exceed the consumption requirements of employees and workers. (Obviously these two last assumptions are over-optimistic, for why would the public sector lower its prices in this case if it doesn’t intend to subsidize the private sector and/or the wage and salary earners?)

Let \( (1-n) \) of the public sector products be sold below the marginal cost of their production, then \( nY_m \) is sold at a loss that must be compensated by increasing the profits from the sale of the rest of the public sector’s products. Let the loss be represented as a ratio of the sector’s income \( u \), then the disposable revenues for accumulation will be:

\[
Y_m^* Y_m (1 - g_2 w_2 u)
\]

The growth equation for the public sector will be modified to:
Let's see the effect of the other (optimistic) assumption: that the private sector will be obliged to lower the prices of its products proportionately with the decrease in the prices of the public sector's goods. Now the effect will ultimately depend on the quantity of private sector's goods and services that will be purchased by the public sector. Thus the last modification that will be introduced to the last equation concerns the rate of decrease in the prices of private sector's goods purchased by the public sector, which we will denote $xY_p$, and the growth equation for the public sector will be:

$$Y_n = r_n Y_m (1 - g_2 - w_2 - u) x Y_p$$

As for the private sector, it will benefit by exactly the same amount of loss by the public sector included in equation (19), such that the private sector's revenues, the private sector's disposable revenues for accumulation and the growth equations for the private sector, will be respectively:

$$Y_p = Y_p (1 - g_1 - w_1 - x) Y_m (W_n - W_p - C_p)$$
$$Y_p^* = Y_p (1 - g_1 - x) Y_m (u - w_2) w_3 C_g + C_p$$

With equations (19) and (20), our analysis can lead to discerning the sources of leakage from the accumulation cycles of each of the two sectors. The two terms $[(1-g_2-w_2-u)+xY_p]$ in equation (19), and $[(1-g_1-x)+Y_m(u+w_2)+w_3 C_g - C_p]$ in equation (20) are, in fact, the rates of saving: $s_g$ and $s_p$, in the public and private sectors respectively. A perfect competition between the two sectors can only occur when the rates of savings for both are identical, which the above analysis, as well as the empirical data on state controlled economies of this type, have shown to be impossible. It is because of the larger leakage from the state sector that the tendency to 'enrich' private profiteers is inherent within these regimes.

In the above analysis, we noticed that $(uY_m - xY_p)$ tends to be negative, because while the state can decree the rate of decrease in the prices of its goods, there are limits on such a procedure for the private sector beyond which any pressure on it to lower the prices of its products will be tantamount to sending it to bankruptcy. And in order that the public sector can compensate for its losses it will have not only to raise the unit price of its other products but to sell increasing quantities of the profitable products, as well as buying additional units of the private sector's products whose prices were lowered. But this process entails, in fact, boosting demand on the private sector's activities. And here we find a crucial element in the working of state capitalism.

For up till now we have dealt with the expenditure side of the growth mechanism; i.e. the demand side, which is a valid proposition given that it is state expenditure and demand that plays a major role in boosting economic activity under such regimes; whose policies represent perhaps an overheated Keynesian model. On the supply side, the
implicit assumption has been that both sectors have a fully flexible system of production that can respond to changes in demand, which obviously is not the case. However, the allocation of physical resources, and not only the financial ones, is different in both sectors. As the state boosts demand through its financial resources, the response will come from both sectors in the form of additional supply, or in the form of inflation when supply cannot match demand. This is all the more important in the case of non-tradable goods and services, where the private sector enjoys a quasi-monopoly (construction), as we have seen.

What this implies is that while some shortages can be met with foreign imports, non-tradables, which are crucial for the functioning of the state activities, can only be boosted by giving more concessions and encouragement to the private sector. Thus a major characteristic here is the complementary functions of both sectors rather than their antagonism. This means that one cannot deduce the withering away of the private sector simply from the growth of the public sector or vice versa, because the growth of the latter is dependent on the growth of the former, while the growth of the private sector depends to a large extent on the availability of financial resources in the hands of the state.

This brings us to the conclusion that a balance of activities between the two sectors, through the equalization of their rates of savings and investment, is very unlikely from a theoretical point of view, and has proven to be impossible empirically. Among the additional reasons for that are the tendency of state wages in the first stage of the growth of the state sector to be higher than those of the private sector, even if certain categories of highly skilled workers or technicians are better paid in the latter, and the tendency of wages and salaries within the administrative apparatus to catch up with that of the public sector proper in addition to the pressures created by the unemployed to find jobs in the state apparatus in both fields: administrative (including military and paramilitary) and productive.

Moreover, as the state begins invading the productive spheres, it justifies this move by the inability of a weak capitalism to invest in heavy and capital-intensive industries, thus it is only logical to conclude that the rate of return on the public investment, even when the returns will not benefit the private sector, will be much lower and will only begin to yield over longer periods of time. One needs only to compare the functioning of both sectors in branches which conventional national accounts statistics lump under one sector: transport and communication. For it is one thing to invest in railroads and airports, as the state does, and it is another to invest in taxis and minibuses, as the private sector does.

Suppose that the capital/output ratio is equal for both sectors (which means that the slope of the growth of both is the same). Then the growth of each will be determined by the disposable income for accumulation of each sector, which will be turned into investment in the next time period. Given all the sources of leakage mentioned above, the state sector will lose from its disposable income for accumulation to the private sector. Thus even if the private sector begins from a low level, it will eventually catch up with and subsequently exceed that of the state sector. The period of time required for that depends on: 1) the ratio of the state disposable income leaked to it; 2) the initial gap between both sectors; and 3) the difference between the propensity to save in each of the sectors.
Figure -1- illustrates the pattern of growth for both sectors within the conditions analyzed above.

\[ Y_{st} = Y_{st}(1 + r_p S_p) \]

\[ Y_{pt} = Y_{pt}(1 + r_p S_p) \]

Where:

\[ rY_m^* \quad rY_p^* \]

\[ \frac{dY_m}{dt} \quad \frac{dY_p}{dt} \]

\[ Y_m \quad Y_p \]

\[ S_1 = \text{Public sector saving rate} \]

\[ S_2 = \text{Private sector saving rate} \]

---

**Figure -8.1-**

Growth Patterns of the State and Private Sectors
Figure -8.2-
Growth Paths under Condition of Equilibrium

\[
\begin{align*}
\frac{dY_m}{dt} & = rY_m^* \\
\frac{dy_p}{dt} & = rY_p^* \\
Y_m^* & = Y_p^* \\
S_1 & = S_2
\end{align*}
\]
Figure 8.3 - The State Capitalist Model in Equilibrium
8.2 The Life Cycle of State Capitalism:

In the post-WWII era, Egypt was the first third world country to adopt some form of non-Marxist socialism (Arab Socialism) as a state policy. This entailed the establishment of a unique ruling party, the Nationalist Union which was later renamed the Arab Socialist Union, and the adoption of a five-year development plan. In 1956 Egypt nationalized the Suez Canal in 1956. And between 1960 and 1961 all private banks and insurance companies and more than two hundred industrial, trade and transport companies were nationalized in Egypt and Syria⁵ (Al Siba’i 1975: 326-36). Iraq followed suit in 1964 when it nationalized all foreign and national private banks, insurance and reinsurance companies in addition to thirty commercial and industrial companies (Al Hafidh 1971: 80).

State capitalism was not only a feature of the Mashreq countries in the 1960s and 1970s, as we mentioned earlier. The Mashreq state capitalist regimes, however, differed in certain respects from the other third world statist regimes. One can safely state that outside the Mashreq, state capitalism tended to dominate in countries which suffered from extremely narrow markets; i.e. countries whose per capita incomes and/or size of the population is low. This statement can be substantiated by the argument that this system has higher chances of achieving some positive growth results where there are no incentives and no sources for a local private capitalism to develop. In this case the state capitalist mechanism described in the model can provide incentives for an indigenous capitalist class to develop on the basis of catering for a new consumer: the state, which will act as a powerful engine to enlarge the market. In essence this is a Keynesian mechanism applied to a non-industrialized economy. In the meantime, the flow of resources to private hands will take more time before a mature capitalist class can develop, because of the initial low level of development.

Hence, it is no coincidence that out of fifteen countries that passed through a system of state capitalism until the mid 1970s, only Iraq had a per capita income above $200, while six countries had a per capita income between $100 and $200, and in eight countries it was less than $100. As for the size of the population, only Egypt and Burma exceeded the twenty million mark, two countries had a population between ten and twenty million, six between five and ten millions, and six below five millions. So generally speaking Iraq, Syria and Egypt embarked on the state capitalist path enjoying

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⁵ Between 1958 and September 1961, Syria and Egypt were united under the name “The United Arab Republic”. The nationalization decrees thus applied to both countries. Following withdrawal from the union, Syria kept the nationalized institutions under state control.
relatively higher potentials for the emergence of private capitalism via state interventionism.\(^6\)

The mathematical model presented above has tried to establish that the functioning mechanism of state capitalism tends inevitably to divert increasing resources to private channels. This tendency can be gauged from calculating the sectorial output/capital ratio of both the private and the state sectors in a given economy.\(^7\) This is, in fact, a composite index of two simpler coefficients: the output/capital ratio for the state sector, and the same ratio for the private sector. Each of these coefficients can be taken as a rough indicator of the productivity of each of these two sectors.\(^8\)

The composite index is reached by dividing the coefficient of the state sector by that of the private sector and is meant to give an indicator of the relative productivity of each. The respective coefficients for each of the two sectors, state (\(g\)) and private (\(p\)) will take the following form:

\[
\frac{Y_g}{Y} \quad \text{coefficient by the first}
\]

\[
\frac{K_g}{K} \quad \text{coefficient by the second}
\]

\[
\frac{(Y - Y_g)/Y}{(K - K_g)/K}
\]

\[
\frac{Y_p}{Y}
\]

\[
\frac{K_p}{K}
\]

This is reached by substituting \(K_p\) and \(Y_p\) by \((K - K_g)\) and \((Y - Y_g)\) respectively.

Thus, a value of one means that both sectors are performing at equal levels of productivity, while a value greater than one means that the productivity of the state sector is higher, and vice versa. However, one can reach interesting conclusions on the working of different systems by observing a time series of this index under Soviet type economies, and third world state capitalist systems.

In a period of 'socialist' transformation under Soviet type economies, the quotient of state/private output/capital ratios tends to increase until it reaches infinity or a maximum constant ratio. The first case —infinity— is reached when full nationalization of private means of production is achieved, and therefore we are dividing the state's output/capital ratio by a zero investment. However, in most other Soviet-type cases a tiny space was left for private activity. This was the case especially in Poland where the agricultural sector was not collectivized. In this case the initial waves of nationalization managed to put increasing proportions of the national output in the hands of the state. Even with the relatively huge state investments, whose immediate effect will be to lower

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\(^6\) All figures from UN Yearbooks of National Accounts Statistics for the years when the relevant countries established state capitalist regimes. Additional evidence that government spending may play a more stimulating role in smaller countries, are the findings of Chenery and Syrquin (1975: 200-207) from a study of 104 countries. They found that in every income group government spending in countries with populations of less than 15 millions was higher than in those with higher populations. Whereas government spending in the first group of countries ranges between 0.162 at per capital levels of $100 and 0.32 at levels of $1500, the respective range for larger countries was 0.133 and 0.216.

\(^7\) However, calculating this criterion is not as easy as it may seem, because the national accounts statistics do not normally show the total amount of capital, but only the annual sums of investment, i.e. the additions to the existing capital stocks capital minus the sums allocated to compensate for depreciation.

\(^8\) And this coefficient can be refined to reach more accurate conclusions if it can be calculated off the net material product of each of the two sectors.
the output/capital ratio for the state, the proportion of this to the private sector’s output/capital ratio will also tend to rise, because the goods and services produced by the private sector will approach zero, or will be kept at a minimum.

Applying this indicator to the case of third world state capitalism will show a radically different performance, despite the appearances. Here, the initial phase of rising sectorial state-private output/capital will be reversed in a second phase. This is because an initial phase of nationalization leads to a surge in the state’s share in the national income. In this period the share of the state in income rises more than the rise in its contribution to investment. But afterwards it is the state that does the bulk of investment, including (as we have shown in the model) those investments that would eventually benefit a private sector that complements the work of the state sector.

Therefore, rather than attempting to decipher the nature of state capitalist regimes in the Mashreq (or elsewhere) through analyzing the discourse, intentions, or even the social backgrounds of their leaders, it is this process of complementary interaction between the private sector and the state that defines the limits, contradictions and ultimate outcome of these regimes.

The large state investments in new branches of industry, communication and services, as well as the tremendous expansion in the size of the bureaucracy meant the creation of a lucrative market for new and expanding private products and services. And it is in this sense that we can label state capitalist policies as ‘Keynsian’. The fact is that the private sector in each of the Mashreq countries kept expanding in construction, trade, agriculture, services and transport, while the bulk of the gross capital formation was shouldered by the state.

Table -8.1-
Civil Servants and State Sector Employees under Three Nationalistic Regimes*

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9 Reliable statistical data from the early transformative periods of the USSR and Eastern Europe are very scanty. Nevertheless, relying on the data provided by Ellman (Ellman 1975), the present author attempted to calculate these indicators for the period of the first five-year development plan of the USSR. The results were positive.

10 The surge of anti-capitalist and anti-colonial measures during the 1950s and 1960s, however, did not really lead to sweeping nationalization acts of Western enterprises in the third world. A study of these acts during the period 1956-1972 found that only eight third world countries nationalized more than 80 percent of foreign owned assets. These countries are Algeria, Bangladesh, Burma, Chili, Cuba, Egypt, Iraq and Syria (Williams 1975: 260-74).

11 A cross-sectional study of more than eighty third world countries showed that, with the exception of India, the state’s share in the gross domestic capital formation in the third world was between 25 and 40 percent throughout the 1950s and 1960s. This share is considerably higher than its counterpart in the advanced capitalist countries, which has reached the range of 20-40 percent only in the early 1970s and after a century-old rising trend (Reynolds 1971: 537).
The following figures have been compiled from the available data on Iraq and Syria and they give a fairly good idea on the performance of the private sector in both countries under their statist regimes. Keeping in mind that unlike the state sector, private activities tend to hide much of their activities for fear of political harassment, nationalization or taxation while they tend to inflate their investment costs, we can safely assume that these activities have fared much better than what the official data, which are our source, present.

Until 1989 the contribution of the Syrian private sector in investment activities was lower than the state sector plummeting to around 30 percent in some years (figure 1). Nevertheless, its declared share in the national income never went below 50 percent and actually began to surpass the state’s share in the 1990s. This share, it must be emphasized, cannot be explained by its higher investment contribution in the 1990s, since these investments require a gestation period before they begin to yield returns. Thus even when the private sector’s share in investment was lower than that of the state, it could extract more resources and it is not far from reality to expect that its higher investment activity in the 1990s would make its share in the national income much higher in subsequent years.\(^\text{12}\)

Nowhere has the dependence of the private bourgeoisie on the state been as pronounced as in the case of Iraq. From an average 40-45 percent contribution to the gross fixed capital formation before 1964, when the nationalization decrees were passed, the private sector’s share plummeted to less than 20 percent throughout the 1970s and 1980s (figure 3)\(^\text{13}\). Despite this low level of costs incurred by the private sector, its share in the country’s GDP rose steadily throughout the 1980s. But because the bulk of the state sector’s share in GDP is mainly accounted for by oil (50-60 percent of GDP on average) and public administration, we can easily see that the private sector not only surpassed the state in its share of non-mining material production. With oil being mainly a foreign exchange generating sector in the economy and for the state, the latter became

\(^{12}\) See below, on the post statist 'reforms' in state capitalist regimes.

\(^{13}\) Changes in Iraq’s social structure and economic performance following its invasion of Kuwait in 1990, the Gulf War and the imposition of an international embargo on it will not be discussed in this book. While the way all these developments have affected the socio-economic and political life of this country have much to do with its pre-war structures, they nevertheless introduced new trends, some of which have been treated in al Khafaji 2000 b.
not the major producer in the economy, but the major purchaser and employer of the workforce.

Figure -8.4-
Syria: Gross Fixed Capital Formation by Type of Ownership
(At Constant 1985 Prices)

Source: Based on Data from Syrian AAS (1996):544
Figure 8.5
Syria: Public & Private Sectors Percentage Contribution to the Net Domestic Product in Manufacturing Industries
(at factor costs, million Syrian Pounds, Current Prices)

Source: Calculated from the Syrian AAS 1996: 182-183, and 1972: 72
Figure 8.6 -
Iraq: Percentage Shares of Private & Public Sectors in GDP
(Current Prices)

Source:
1964-1971: Ministry of Planning (1972:3)
1972+: Various volumes of Iraqi AAS
Figure – 8.7-
Iraq: Percentage Shares of Private & Public Sectors in Non-mining GDP

Figure – 8.8-
Iraq: Percentage Shares of Private & Public Sectors in Gross Fixed Capital Formation
However, whether the third world state is endowed with resources that enable it to acquire a financial autonomy vis-à-vis society or not, state capitalism reaches its limits when it ceases to be a means of centralizing and mobilizing resources, and becomes rather a vehicle for diverting resources. In oil producing Algeria, Iran and Iraq, and in Egypt, where the state’s autonomous access to foreign exchange is ensured via its ownership of the Suez Canal, state capitalism reached its limits with the mounting deficits in its balance of accounts, rising inflation—because of the systematic recurrence to uncontrolled state expenditure—, deteriorating real wages and salaries, and budgetary deficits.

These symptoms almost always began to surface after around two decades of implementing state capitalist policies, thus forcing the abrupt or gradual shift of the state from expanding its intervention in the economy and desperate moves to encourage the private sector to fill the space that the state was no longer able to fill. And it is here that the international atmosphere of the cold war and relative prosperity had a favorable impact on third world state capitalist regimes, because it allowed the state to go beyond its domestically raised resources for relatively longer periods.

By the mid-1970s, Egypt abruptly announced that it was abandoning its Arab socialism by adopting an ‘infitah’ (open door) policy, thus liberalizing the economy and, to a much less extent, political life. The radical turn of Egypt’s policy came at a time when the ideology of state interventionism worldwide, as well as the superpower competition and economic nationalism in the third world were still the basic ingredients of the international system. Iraq, on the other hand, announced its ‘administrative revolution’, as it called its massive privatization program in 1986-7, while Syria passed laws opening hitherto forbidden avenues for private capital in 1991. Thus it seems far from true to ascribe changes towards liberalization in the third world merely to international factors.

The “twilight of state capitalism”, to quote John Waterbury (1991), ushers in when the drain on the state’s resources reaches a point that it can no longer carry its welfare programs and the ownership/entrepreneurship role in the meantime. Meanwhile, the private sector reaches a level of accumulation that it demands more and more incentives and economic liberalization measures which put increasing pressures on the state.

However, by ‘private sector’s demand’ one should not necessarily have in mind a concerted collective political act on the part of local capitalists demanding the withdrawal of the state from economic activity. The argument against such an instrumentalist view is that the relationship between state and private capital is a complementary one under state capitalism, as we have seen. Thus many important sectors of the local bourgeoisie would be the main losers from a complete state withdrawal. Second, in a situation where the power relations between the private sector and the state tilts towards the former, i.e. when the state is evidently desperate to engage the private sector in more economic activities, the local bourgeoisie has the powerful weapon of ‘capital strike’—according to Michael Kalecki (1972). But once again, ‘capital strike’ is not necessarily a deliberate act of opposition to the state. When investors do not see the existing measures and incentives sufficient enough to induce them to commit their resources to new branches, this will only translate into political pressure on the state.
Obviously, the response of each state to such pressures varies according to a multitude of factors. Monolithic and paternalistic state structures can face the risk of total collapse if too much concessions are made to private investors, while welfare regimes can afford to undergo some liberal (though painful) transformations that preserve the status quo—at least for a while.

8.3 The Historical Significance of State Capitalism:

Not only did the leaders of the Mashreq statist regimes believe that they were establishing a new and specific type of socialism, but also many liberals and Marxists within these countries and abroad. The liberals viewed the nationalization of some private companies as a definite proof of the anti-capitalist nature of these regimes, while many Marxists—especially in the Soviet camp and the communist parties—saw these regimes as transitional to socialism, or at least having the potential to do so.

The above analysis, however, has shown that despite the intentions and convictions of the leaders of the statist regimes, their systems had two inherent and complementary tendencies: 1) the eventual breakdown of the state sector; and 2) the diversion of resources to the private and the formation or consolidation of economically powerful strata of private contractors, brokers, merchants and middlemen.

Seen in historical perspective, it may not be difficult to find strong affinities between these statist regimes and other pre-WWII experiences which relied on intensive state intervention without adopting any ‘socialist’ labeling, to overcome underdevelopment. Kemalism in Turkey, Peronism in Argentina and Sukarno’s ‘directed democracy’ in Indonesia are just two early examples of this trend. In East-central Europe several countries had experimented with state intervention in the first four decades of the twentieth century (Berend and Ranki 1974).14

The historical reasons and conditions for state interventionism in the third world, or among late-developers, and the role and characteristics of states in providing a powerful means to modernize their economies and societies have become too familiar to deserve restating here. The principle of state intervention, even state property and control of certain sectors in the economy in order to offset the retarding and destabilizing effects of spontaneous market action is acknowledged today by a wide array of intellectual schools (Gerschenkron 1962, Myrdal 1968, Kemp 1973, Wallerstein 1973). The argument that Britain and the U.S. managed to industrialize in an ‘exceptional’ laissez-fair way has been seriously undermined by economic historians. Phyllis Deane

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14 It is noteworthy that development economics and sociology rarely paid much attention to the pre-WWII modernization attempts in non-industrialized regions, such as Eastern-Central Europe and Latin America although many lessons could be drawn from their early experiences. The reasons for this neglect, it seems, lie in the fact that development theory itself saw the light in the closing years of WWII. Its subject was to draw policies to rid the then ‘backward’ countries from their poverty. The previous history of these regions, that is the policies adopted before the coming to light of development theory, seemed pre-history that was irrelevant from the point of view of the nascent discipline. As the cold war era was ushering in and an arbitrary demarcation line was clearly drawn between ‘first’, ‘second’ and ‘third’ worlds’, cases from non-third world regions were simply dismissed beforehand because they were deemed non-applicable to the newly invented ‘third world’. Ironically, one of the earliest texts heralding the birth of development theory was a 1944 attempt by Paul Rosenstein-Rodan to draw policies for the ‘backward’ (pre-socialist) Eastern Europe. For this and other earlier tests, see Meier 1975.
had shown how British industrialists have received during the century preceding the industrial revolution aid and incentives from the consecutive nationalist and aggressive British governments in order to discover new skills, invent new techniques and expand markets. The infant industries were helped by high tariffs, while naval power provided the basis for commercial expansion (Deane 1965: 144-5, 209-10, Mason 1961: 28, see also Wallerstein 1973: 12). On the American experience, Paul Bairoch shows that "the modern protectionist school of thought ... was actually born in the United States" and that the United States "far from being a liberal country as many think, can be characterized as 'the mother country and bastion of modern protectionism' (Bairoch 1993: 23,30).

Establishing the relationship between political/state intervention and the take-off to industrialization, however, is not to specify the precise way and/or conditions under which states can be effective in their intervention, nor the social nature of the industrializing regime that will ensue from this intervention. If development necessitates state intervention, the opposite is not true; i.e. that development is the product of interventionism. In the post-WWII era ex-socialist, advanced capitalist, as well as third world states vigorously intervened in running and restructuring their economies, but the mere persistence of underdevelopment testifies to this fact. Thus in order to contextualize the Mashreq étatist experiences we are confronted with the following two questions: first, what was the social nature of these regimes? Second, why didn't they lead to the rise of self-sustained industrialized economies?

As was mentioned earlier, leaders of the Mashreq revolutionary regimes espoused a variant of socialism that was in favor of the small producer and serviceman, be that a peasant, an owner of a small factory, a shopkeeper, a lorry driver or a state employee. The social backgrounds of these leaders and of their party and work companions undoubtedly shaped their worldviews and notions of justice and equality. In advocating their socialism, these leaders were very aware of their differences with Marxism, going at times to treat it as their main enemy and challenger, while inventing some authentic national roots for their own brand of socialism. A major difference that they made clear from the outset, even when they were nationalizing some private businesses, is that Arab socialism does not oppose the principle of private property of the means of production (Abdul Nasser 1955, Aflaq, 1958, Gotheil 1981).

We have seen, however, that the outcome of transformative programs; i.e. programs undertaken during revolutionary periods, has little to do with the aspirations, worldviews, or backgrounds of the initiators of these programs. Put more accurately, when the leaders’ aspirations and practices diverge from those of the rising interests within society, then those leaders would be swept away by others who can articulate the

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15 On an empirical level, D. Horowitz (1965: 49-73) analyzed government expenditure as a ratio to GDP in a number of developed and developing countries. He found that there is a positive correlation between accelerated economic growth and the share of total government expenditure, and some of its important items, to the GDP in a number of highly advanced and underdeveloped countries.

16 In a lecture given in 1951, Michael Aflaq, the founder of the Ba’th Party and until his death the General Secretary of the Iraqi branch of the party, explicitly declared that he had been more influenced by German philosophers like Nietzsche and Fichte than by Marxist socialism. The text of the lecture was later withdrawn from publication because it gave the Ba’th opponents ample ammunition to show the fascist nature of the party.
rising societal expectations. And it is in this way that the transitional revolutionaries were replaced by more radical ones, as we have seen above.

Just like the classless society, or the society of Fraternity, Equality and Liberty, for which the Russian and French revolutionaries thought they were laying the foundations, the much more modest Arab socialist society ended up in a radically different manner than the dream of its founders. Russian and French societal structures defined the limits and outcomes of the transformative programs of their respective revolutionary leaders the way the Mashreq societies articulated the transformative programs of their leaders. Therefore we should look at the social characteristics of the Mashreq state capitalist regimes through the prism of their actual effects and not the intentions or wishes of their leaders.

Our analysis has shown that the Mashreq state capitalist systems differ significantly from the Soviet model in that the private sector does play an essential role in the functioning of the former. By contrast, even when some activities are kept in private hands under the Soviet-type economies - Polish agriculture, for example - their existence is of no consequences for the functioning of the system. In other words, while a theoretical model for the functioning of the Soviet system can neglect any reference to the existence and impact of the private sector, this is impossible in the case of the third world statist regimes.

Under the economic mechanisms of statism in the Mashreq the formation, consolidation and enrichment of private capitalists are not deviations. They are constitutive elements of the system, as we have seen. Therefore, the functioning and practices of this type of systems is perfectly comparable to cases of capitalist transformations elsewhere. By doing so, we should keep in mind the conclusions drawn from the previous chapters, mainly that the pioneer capitalists in Europe had nothing to do with those financiers, merchants and industrialists of the pre-revolutionary era, who in many cases stood on the side of the ancien regimes. Revolutionary acts targeting the affluent mercantile, and even industrial, strata cannot by themselves be taken as acts against capitalism per se. Second, the rise of wide groups of humble origins to affluence is a characteristic, rather than an anomaly, of modernist revolutions.

With these considerations in mind, one may compare the statist regimes with the successful industrialization attempts where state ownership of productive assets was a temporary means that invigorated private capitalism. In 1799 the Swiss authorities bought four weaving machines and run them directly. When their profitability was assured, they were sold to private industrialists (Kemp 1973: 50-5). The Prussian state not only provided protection and long-term credit to private capital, but went into running steel and lead industries and nationalized coal mining in order to provide cheap energy sources for industrialists (Cole and Deane 1965: 17). In Japan, the state owned practically all the modern branches in industry until 1880 (Lockwood 1955: 18-39, Emi 1963: 25, Rosovsky 1961: 58). The French state did not abandon its control over joint stock companies until 1863. And it only recognized the formation of limited liability companies as a public right in 1867 (Kemp 1973: 69).

Looking at the statist experiences in the Mashreq, we see a similar pattern where the new regimes considered modernization and industrialization a top priority. Reluctance of the private investors to engage in the state’s efforts was followed by
nationalization and reliance on the state initiatives. This was followed by privatization campaigns.

But if our comparison with the successful industrialization attempts is valid, then we have to answer the crucial question of why did the Mashreq’s attempts lead to a drastic failure? In order to address this complex question, we have to move beyond pure economic analysis, and try to look at the making of the nouveaux-riches and their relationship with the statist regimes.