DEMOCRACY AND INCLUSIVE GROWTH
States, markets and enterprise in India, Brazil and South Africa

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A consortium of think tanks from rising democracies
india brazil southafrica
INCLUDE - is a new consortium of think tanks from three developing countries: India, Brazil, and South Africa.

India, Brazil and South Africa are democracies wrestling with the challenges of driving economic growth, dealing with mass poverty, the politics of inequality and the dynamics of rapid social change. New ideas, new approaches to development and new experts are emerging in India, Brazil, South Africa and elsewhere in the developing world. INCLUDE seeks to learn, document and build insights from this set of experiences.

This issue has been edited by Ann Bernstein. The report summarises the proceedings of a Round Table hosted by CDE in 2011. It was written by Peter Draper and Ann Bernstein.
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ABOUT INCLUDE

INCLUDE is a new consortium of think tanks from three developing countries: India, Brazil, and South Africa. It has three main objectives, namely to:

- Develop comparative knowledge and policy insights into development strategy in the three countries;
- Utilise these comparative perspectives to strengthen each think tank’s influence in national policy reform processes in India, Brazil, and South Africa; and
- Facilitate greater ‘voice’ from the democratic South in global debates about development.

INCLUDE seeks to provide an independent perspective on growth and development in rising democracies, casting greater light on how these three countries are seeking to achieve sustained and inclusive growth in dynamic, democratic contexts.

By strengthening and drawing attention to the successes achieved in these democratic countries, it aims to influence other developing countries.

Centre for Policy Research (India)

The Centre for Policy Research (CPR) is an autonomous, non-profit, non-partisan research organisation and a leader in Indian public policy research. CPR’s major strategic objectives are to investigate policy issues facing the Indian polity, economy, and society; build a comprehensive body of policy-relevant knowledge; and provide policy alternatives. In order to achieve these goals, CPR works in close cooperation with policy-makers, academic policy researchers, and the media. It also manages several special-interest research initiatives. One such initiative is the Accountability Initiative, which regularly tracks and provides reliable and accessible information about the implementation of service delivery programmes in India. CPR also seeks to inform the accountability debate in India, thereby strengthening accountable governance and citizens’ engagement in India’s governance processes.

Instituto Fernando Henrique Cardoso (Brazil)

The Instituto Fernando Henrique Cardoso (IFHC) was founded in May 2004 by former Brazilian President Fernando Henrique Cardoso. Bringing together politicians, intellectuals, civil society, and young people, the Institute aims to produce and disseminate knowledge about the challenges of development and democracy in Brazil and the wider world, especially Latin America. The research focus is on economic and social change and the challenges they pose to democracy. The Institute does not limit its focus to economic issues, but is more concerned with political and socio-cultural dynamics.
Centre for Development and Enterprise (South Africa)

The Centre for Development and Enterprise (CDE) is an independent policy research and advocacy organisation, widely recognised as ‘South Africa’s most respected policy centre for social and economic development’ (*Financial Times*). CDE undertakes research on key development issues and their relationship with economic growth and democratic consolidation. With core funding from South African companies, CDE has a special focus on the role of business and markets in development. Comprehensive assessment of South African realities and international experience enables CDE to formulate practical policy proposals that outline the ways in which South Africa and other middle-income developing countries can tackle social and economic challenges. With 17 years of experience in research and innovative policy analysis, CDE has established itself as an authoritative voice in policy debates, has a remarkable ability to capture media attention, and is read and heard at the highest levels of government.
EXECUTIVE SUMMARY

Given China’s phenomenal achievements over the past three decades, and its growing global power and influence, debates about growth and development are taking place in a changed environment.

Many political leaders in the developing world as well as many other experts and interests now associate successful development with autocratic or authoritarian political systems. Yet many democracies in the developing world are also making significant progress, and notching up real achievements.

The key challenge – which has huge implications for global development and the future of the global community – is to demonstrate that these societies can effectively address issues of growth, poverty and inequality in a democratic environment. And by so doing, and because they are democracies, generate a better quality of life for the vast majority of their citizens.

This is a primary reason for the establishment of INCLUDE, a consortium of think tanks from rising democracies in the developing world. This is a bold initiative and the aim of learning from three vitally important countries – India, Brazil and South Africa – is an ambitious endeavour. The consortium will structure its work under the broad umbrella theme of democracy and inclusive growth. We intend to learn more about each other’s countries and look for comparative insights. This new knowledge will be used to strengthen each think tank’s activities in promoting domestic reforms in their own country; and our comparative country insights will be used – in time – to influence other developing countries and the global conversation about development strategies, priorities and achievements (see Page 2 for information about the three think tanks).

The dominance of highly-industrialised developed countries, their politicians, media, intellectuals, and experts in shaping global conversations about development and growth is striking to those who live outside traditional global centres of power and influence. Policy agendas influenced by these countries are often out of touch with the realities of developing countries.

INCLUDE held its first public event – a workshop involving all three think tanks, and leaders in business, government, academia and others – in Johannesburg, South Africa, in March 2011. The workshop explored key issues in the three countries focusing on the role of states, business, and markets in achieving higher and more inclusive economic growth (see Page 12 for a list of participants at the workshop).

This first workshop demonstrated the vital importance of getting beyond the slogans, the PR images of countries, and into the particularities of what is actually happening. India, Brazil and South Africa are three very different societies on three complex and diverse continents. All are democracies wrestling with the challenges of driving economic growth, dealing with mass poverty, the politics of inequality and the dynamics of rapid social change.

What has been called ‘the rise of the rest,’ that is, the developing world, will have economic, political and other consequences. There are new ideas, new approaches to development and new experts emerging
in India, Brazil, South Africa and elsewhere. INCLUDE aims to learn, document and build insights from this set of experiences.

In this short summary of a longer report, we will describe some of the challenging and interesting ideas and insights arising from this first workshop.

**States and markets**

This topic encourages considerable rhetoric and ideological positioning. It is important to dig deeper and think harder about the realities behind the bombast. We need to debunk false dichotomies between the market and the state.

The advocates of the so-called ‘Washington Consensus’ for developing countries themselves often lived in industrialised countries with very large states. Even before the 2008 economic crisis, many Western countries had states that accounted for nearly half of GDP.

All three countries encompassed by this initiative have very large state sectors. In India the state sector remains dominant, at over 50 per cent of GDP. In Brazil, under military rule in the 1960s to 1980s, state-owned enterprises multiplied, and although significant areas of the economy have been privatised, large sectors are still in state hands. In South Africa, modest attempts at privatisation ground to a halt in about 2004, and many important economic sectors (including electricity, rail, road, air transport, and ports) remain state-dominated.

How the state manages globalisation in relation to market forces differs in each country, and is expressed in different institutional arrangements. The debate within each society about these issues and the national interest is ongoing.

Effective market economies require smart states. Governments that ensure excellent infrastructure can greatly boost market dynamism; governments that ensure quality education for all their citizens reap massive returns. However, this requires state officials who are competent, able to manage large systems and complex projects, and able to regulate sophisticated companies. It also requires politicians and state officials who want markets to work and can accurately gauge the complex relationship between effective state performance and market-friendly intervention. In too many instances the three countries are experiencing great incompetence and inefficiencies in their state sectors, or a political desire for a more activist state that hampers rather than facilitates the development of markets. Reforming large public sectors in these societies is a huge and common challenge.
Business and government

There is too much loose talk about markets, states, business and government. These are not interchangeable terms.

The role of the business sector in economic reform differs greatly in each of the three countries, in part as a result of their particular histories. However, in all three, large companies have had to move away from the special deals that characterise undemocratic situations or highly state-oriented systems, to participating in the public debates about general rules for governing economic activity and corporate opportunity. There are therefore increasing areas of common interest and comparability across the three countries concerning how companies participate in the democratic public square.

All three societies need to assess for example whether the liberalisation of their economies is leading to state capture by powerful business interests, and if so, how this can be countered or contained. Corruption is a growing challenge in all three cases.

Democracies with a free press and vigorous civil society organisations have an advantage in this arena. Laws can encourage transparency, watchdogs can be established, and the media can report on corruption, thus encouraging remedial action by the state, or allowing voters to know what is happening. However, enforcing vigorous and intense competition among companies (and political parties) is probably one of the most powerful tools for preventing business from capturing the state. Public education about the value of competitive processes would also make a difference.

Economic growth changes attitudes

The impact of higher levels of economic growth on a particular society can be profound, and the workshop yielded some striking examples.

In Brazil, as the economy started to grow and people saw new opportunities opening up in the private sector, their expectations of the state changed. With the expansion of the middle classes, an increasing part of the population buys market-based education and health services (private schools and health insurance). While new members of the middle class still worry about the provision of public basic health and education, they are ever more concerned with access to and effective regulation of private providers.

The growth of Indian multinationals has changed the way in which other countries and companies view not just those Indian companies but the country itself. India is now seen as a much more attractive place in which to do business than before. Within India, leading edge companies have become ‘national icons’ – an unexpected and remarkable phenomenon, considering India’s past. The corporate leader as national hero is a different approach to traditional development theory.

Many South African companies have expanded successfully into Africa, and some have become global players. Many of these companies regard themselves as ‘ambassadors’ for the country and even the continent, spearheading a new era of African growth and potential.
The challenge of sustaining reforms

One set of challenges needs to be overcome when embarking on economic reform, and another when attempting to maintain the momentum of reform.

In all three countries, market-oriented reforms have taken place over the past 20 years, yet much more needs to be done. All three have introduced sensible macroeconomic management; but the vital micro reforms that complement, provide momentum and give meaning to this macro consensus have not been followed through or taken far enough.

All three countries face enormous threats to their competitiveness. Compared to China, for example, they lag in respect of infrastructure (Brazilian airports, South African ports, Indian roads); the quality of schooling (although Brazil is now seen as one of the fastest improving systems from a low base); and both Brazil (less so) and South Africa lag badly with respect to higher economic growth rates so essential to drive inclusive growth and sustain democracy in these societies.

The genius of politicians – as opposed say to economists – is that their expertise lies in ‘seizing the moment’, opportunistically turning a crisis into an opportunity and moving situations in a new direction. They have reform proposals ready for when situations allow new ideas to emerge and transcend the obstructive or vested interests so that the unpopular can become a new unavoidable and necessary priority.

Successful reform requires the development of a supportive coalition of interests around the reform process so as to maintain the necessary momentum. Some Indian states are doing this better than the federal government, and Brazil seems to have built some momentum for reform across party lines now being tested in the third reform presidency of Dilma Rouseff. In South Africa reform seems stalled for now as internal debates within the ruling alliance take centre stage at the expense of effective leadership of the country.

Inclusive growth

This fashionable new phrase is used by the governments of India, Brazil and South Africa, but is seldom clearly defined.

In all three countries, social mobility is a reality with political consequences. Brazil recently had a president who rose from the dirt-poor north east of the country to the very top of society, and a vice-president from a similarly disadvantaged background. South Africa’s president and many members of its cabinet come from poor families. The Indian prime minister is the exception, rising from that country’s very well-educated elite, but the heads of many regional states come from the most deprived groups in India, including the ‘formerly ‘untouchables’. 
In India, ‘inclusion’ has been seen in a number of ways. The Indian constitution of 1950 outlawed social exclusion through the caste system, and this has been coupled with aggressive affirmative action. Economic inclusion has included traditional redistribution, including land reform that has not gone very far; and the development of a safety net which comprises the national rural employment guarantee scheme, a subsidy for food grains, and a public sector distribution system.

The more interesting and sustainable aspects of inclusion in India involve growth and private activity. As economic growth has accelerated, the question of who participates in this growth has emerged.

The second aspect of inclusion in India has been demand-led. The phenomenal expansion of private schooling across a range of income categories from the poorest upwards is a powerful example. Parents are ‘voting with their feet’ to provide their children with access to English-language education, which they know is vital for economic success.

Brazil has adopted an innovative approach to welfare. The formal economy is based on a minimum wage and pension schemes linked to inflation. With respect to the mainly rural poor, the state has pioneered the BolsaFamilia programme providing very small amounts of money to a well-targeted population on condition that children attend school and receive regular vaccinations against preventable diseases. However, there is a debate about the respective roles of minimum wages, and BolsaFamilia, in the spectacular growth of a new middle class of some 30 million people. There is also growing concern about whether the formal system is affordable, and therefore sustainable.

South Africa has built up what is probably the most extensive and expensive welfare state in the developing world. It now encompasses some 15 million people, and involves a variety of unconditional grants: for child support, housing, land, free basic services, and old age pensions. The impending introduction of a national health insurance scheme is raising sharp questions about affordability, and sustainability. The country is also witnessing the development of private schooling for the poor.

Distributionist policies to reduce inequality have a very mixed record. Nonetheless, inequalities of opportunity are a vital issue in all three societies.

Economic growth can be more or less pro-poor. Policies favouring economic growth should be the principal means of reducing poverty. Nonetheless, poverty can be reduced under lower rates of growth, depending on the public policies adopted. Brazil experienced lower growth rates in the last 15 years than under the military regime, but reduced poverty more rapidly.

This implies that there should be other policies to attack poverty. Policies on health and education are particularly effective. And there is new evidence in all three countries of the success (and sometimes the failure) of additional approaches aimed at providing mechanisms to help poorer people get into the modern economy and its wealth of opportunities.
Jobs and labour legislation

All three countries have rigid and restrictive labour laws. The pressures for reform differ in each situation.

Remarkably, despite high levels of growth in India during the past 10 years, the proportion of formal sector jobs to informal jobs has not increased. The informal, unregulated sector appears to be interlinked with the formal economy in unusual ways, and is a central component of the high growth story.

In Brazil the rigidity of the labour market is a factor in making the informal and unregulated sector of its economy very large. Nonetheless, the country has managed to grow formal sector jobs.

South Africa has a surprisingly small informal sector, with insufficient clarity on why this is the case – whether this is a question of definition, the legacy of apartheid, or some other factor has not yet been resolved. The three think tanks will work on this area in the future.

In all three countries there seem to be two large agendas often working simultaneously. The first is a set of attitudes and associated reforms favouring deregulation; the second is a set of pressures, vested interests and legislation that are consciously and sometimes inadvertently opposed to markets and greater market access. Consequently market reforms, particularly at the microeconomic level, assume a stop-start character (India opening up to international supermarkets; Brazil and South Africa leaning in a more statist direction at present).

Urbanisation, land reform, and the demographic dividend

Brazil is now over 80 per cent urbanised, and is simultaneously seeing a dramatic growth in ‘the new middle class’ and a reduction in poverty. By contrast, both India and South Africa are ambivalent about urbanisation.

Nandan Nilekani, former CEO of one of the iconic Indian IT companies, Infosys, has written eloquently about the demographic dividend that could be reaped in India if millions of young people were given a decent education and economic opportunities. This is also possible in South Africa, but this potential is being squandered by the massive unemployment rate among young people, the poor education available to most of them, and a health crisis involving AIDS and tuberculosis, which mainly affects younger South Africans. In both countries, bold policy reform could lead to enormous progress.

Brazilian society, on the other hand, is starting to age, which will present policy-makers with a different set of challenges in time.

In all three countries, issues of land reform are important and partially unresolved. In Brazil this is more important in urban than rural areas. The country has achieved considerable progress in providing rural workers with land in agrarian reform settlements. Nonetheless, after 15 years of intense land reform less than 10 per cent of rural settlements of ex-landless people are sustainable without permanent public funding. In South Africa agriculture is a small and declining part of the economy, in part a result of the
negative consequences of a badly-managed land reform process. India is slowly experimenting with the introduction of modern supermarkets with their supply chains, thus moving away from a situation in which some 30 per cent of farm goods are wasted or destroyed before getting to market.

It is hard to see how the modernisation of the rural economy in India, South Africa, and probably parts of the Brazilian northeast, can take place without grappling with the issues central to land reform: inequity and access in a competitive global economy; and finding the best possible route to modernisation with respect to traditional land holdings.

**New models of development**

Whether a new development approach is discernible in these three democratic, middle-income developing countries is not yet clear. Each country is uneven in its stage of development, and more information is needed about major economic sectors.

More broadly, all three countries display a desire for market-driven development. However this is coupled with a historically large state, and a preference for the state to play a major role in strategies for growth as well as the inclusion of more and more people in the modern economy and society. To what extent this is what has traditionally been described as a mixed economy, or the development of new form and content in the developing world, remains to be seen.

At the same time, some of the interesting new developments do not always include the state. Thus ‘private coping’, such as the growth of private schooling for poorer people in India (where it is massive) and South Africa (15 per cent of schools and growing), is one example of how market dynamics are responding to demand.

A second area is the impact of employment. Contrary to the many well-meaning and often state-driven or foreign-funded ideas of how to help the poor, it is clear that employment is often the best way out of poverty and into a world of skills and new opportunities, albeit – initially – at a very low level. The 90 million people moved out of poverty in India over the past 20 years provide a striking illustration that faster economic growth and more market opportunities offer the most sustainable and empowering route out of poverty.

**‘Poetry and plumbing’**

A country’s future is often determined by leaders’ attitudes to the outside world and the policies and strategies that flow from that. It is also determined by the vision which leaders offer their citizens. If poorer people or formerly excluded groups feel they are now part of the development story, their attitudes change, they dream bigger for themselves and their children, and in so doing can drive their society to greater heights. The skill of leadership is to make sure that people are encouraged to think big and that the new opportunities in education, employment and urbanisation are available and working to best effect for as many people as possible.
Development policy inevitably involves a lot of ‘plumbing’ – sober, often highly technical implementation, and tinkering with the physical and institutional conditions under which people live. Political leaders who are nothing but ‘plumbers’ are unlikely to inspire the efforts, and often the sacrifices, necessary for development. ‘Poetry’, the vehicle of dreams, is also called for.

**Democracy and development**

Key to this workshop – and the INCLUDE project – is the issue of whether democracies such as these provide desirable and effective settings for development and inclusive growth.

All three countries are robust democracies. India has been a democracy since independence, with the brief interruption of Indira Gandhi’s emergency rule. Brazil had a long democratic tradition to which it returned after the demise of the military dictatorship. South Africa created a non-racial democracy after the negotiated demise of its apartheid regime.

There is no guarantee that these three countries will remain democracies forever. However, there are few indications that democracy is under threat in any of them. India and Brazil have had democratic alternations of political power, with an opposition party succeeding an incumbent group. Although South Africa has not yet passed this test, the fact that four very successful national and four separate local government elections have been held is a good omen.

Their records in terms of inclusive growth are uneven. Both India particularly, and to a lesser extent Brazil, have grown more rapidly than the South African economy (the relatively recent end of apartheid and some anti-growth policies may help explain this discrepancy). In part because of this discrepancy, the reduction of poverty in the first two countries has been much more spectacular, although in Brazil conscious social policies have evidently played an important role too.

In recent years tens of millions of people have moved out of extreme poverty in India and Brazil. Social mobility in South Africa has been more modest; nonetheless, large numbers of poor people have experienced greatly improved access to basic services such as running water, electricity, and health care, and the indicators of inclusion point upward.

The stories of the three countries already provide solid evidence for the affinity of democracy and inclusive growth. And during the next few years this consortium of think tanks from India, Brazil and South Africa will continue to explore the proposition that democracy provides the most effective and desirable vehicle for growth and development in complex, plural societies in the developing world.
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As a result of China’s phenomenal achievements over the past three decades, and its growing global power and influence, debates about growth and development are taking place in a changed environment.

Many political leaders in the developing world as well as many other experts and interests now associate successful development with autocratic or authoritarian political systems. Yet many democracies in the developing world are making significant progress, and notching up real achievements.

The key challenge – which has huge implications for global development, and the future of the global community – is to demonstrate that these societies can effectively address issues of growth, poverty, and inequality in a democratic environment, and by doing so generate a better quality of life for the vast majority of their citizens.

This is a primary motivation for the establishment of INCLUDE, a consortium of think tanks in India, Brazil, and South Africa. These are three very different societies, on three very different continents. However, all three societies are democracies wrestling with the challenges of driving economic growth and dealing with mass poverty, the politics of inequality, and the dynamics of rapid social change.

New ideas, new approaches to development, and new experts are emerging in these countries and elsewhere in the developing world, in response to these challenges. INCLUDE seeks to learn, document and build insights from this set of experiences.

INCLUDE is structuring its work under the broad theme of democracy and inclusive growth. It intends to learn more about each of these countries, and look for comparative insights. This knowledge will be used to strengthen the efforts of its members to promote domestic reform in their own societies, and influence the global conversation about development.

This publication summarises INCLUDE’s first public event: a workshop involving representatives of all three think tanks as well as other domestic and international experts, held in Johannesburg, South Africa, in 2011. The aim of the workshop was to explore key issues in the three countries concerning their search for inclusive growth, how this term is defined, and the role of states and markets in creating inclusive growth. Issues explored included the notion of the ‘developmental state’; the relationship between business and government, especially with respect to economic reform and the danger of state capture by powerful business interests; the components of inclusive growth, including redistribution; the incorporation of previously excluded sectors of society, and the role of safety nets, including the key issue of how to make welfare states sustainable; and the dynamics surrounding the reduction of poverty and inequality. Lastly, and very importantly, participants began to explore the extent to which democracies such as these provide effective vehicles for achieving inclusive growth.

Experts explored these themes in respect of their own countries, and then began to develop cross-country perspectives. Key comparative insights are summarised and developed in the concluding section.
Introductory Remarks

Ann Bernstein, Executive Director, Centre for Development and Enterprise

This is the first public event of a new initiative: a consortium of think tanks from the rising democracies of India, Brazil, and South Africa. If this works, we will ask think tanks from other middle-income democratic, developing countries – such as Turkey or Indonesia – to join the consortium in time.

The aim of this consortium is to learn about each other’s countries. It seems ridiculous that we know a lot more about the United States or the United Kingdom than other countries similar to our own which are also wrestling with issues of development and faster and more inclusive economic growth.

We have a big theme, namely democracy and inclusive growth, a phrase that seems to trip off the tongues of lots of politicians and others in these three countries and beyond, but whose precise meaning and policy implications seems to us to require intense examination and debate. We want to develop and document success stories from the three countries, and we want to give developing democracies a bigger voice in global discussions on vital issues of development.

Professor Peter Berger, Professor Emeritus and Senior Research Fellow, Boston University

This is an interesting combination of countries for many reasons, among them that all three display various aspects of the relationship between democracy and market economies. Each has a legacy ranging from scepticism to hostility toward business and towards capitalism in general. In the case of India you have the long shadow of the London School of Economics and its view of the world, at least as transmitted by Nehru. In the case of Brazil you had a rather ruthless capitalism under the military regime, but when that regime disappeared, a complex mixture of corporatism, populism, and clientelism took hold. As for South Africa, the governing party has a history of Leninism which also is not a history of great warmth towards business.

Despite this legacy, each of these countries has adopted strongly pro-market economic policies in recent years, although of course there is still opposition to that approach in each of those societies. This provides a context for this workshop, which will focus on what is happening in these societies today.

STATE AND MARKETS IN INDIA

Dr Pratap Bhanu Mehta, President and Chief Executive, Centre for CPR, India

We are discussing three major topics: inclusive growth, democracy, and the relationship between state and markets. Our guiding assumption is that markets work best when they are embedded in a larger institutional context that is itself legitimate. If you don’t have that larger institutional context, markets cannot work. In that sense markets are always creatures of ideology and states.
The first point I would like to make, which sets the stage for any discussion about states and markets in India, is that India is a democracy by self-conscious political choice. For all their venality and other failings, Indian politicians have, at critical junctures, respected democratic and independent institutions.

This partly stems from the legacy of the Nationalist movement which recognised that India could survive as a country only if it was a democracy; in other words, only if it had cultures of negotiation, incorporation, and open and frank exchange. Whenever India has tried democratic incorporation it has succeeded; and you can only move forward through these protocols of negotiation and incorporation.

The Indian constitution was self-consciously anti-revolutionary. This is manifest in all the debates in the Constituent Assembly at that time; its members knew very well that change would be slow and gradual. The political culture was one of democratic argument and decision-making based on consensus, initially embodied in the structure of the Congress Party, and later carried over to the practices of coalition politics.

What that means, particularly in respect of the relationship between state and market, is that in India you are unlikely to get forms of ideological discourse that are polarising in the extreme, such as a Thatcherite free market push, or a Latin American-style left intelligentsia revolutionary discourse. Most reforms are embedded in politics: stealth, negotiation, and partial steps. This has been the character of economic decision-making in India.

Democracies face two kinds of threats. The first is the possibility of elite capture and of elites distorting democracies – only states destroy their institutions, people never do. The second is populism. Both these threats impact on the relationship between state and democracy in India, and can be viewed through the prism of four axes around which a stylised history can be constructed.

The first is the legitimacy of the ruling political coalition. On what does it base its legitimacy? In Nehru's time, legitimacy derived from the Congress Party's long history in the Nationalist movement.

We've shifted away from that conception of legitimacy to one that operates under coalition politics, where essentially legitimacy is built through a very complex system of incorporating different groups into structures of power, and negotiating among them.

The second axis, which is very important in India, is that it is a federation. It has a diversity of states, which has had a profound impact on the development of capitalism. Again, under Nehru there was great formal autonomy for provinces. Later, under Indira Gandhi, the system was strongly centralised and did not respect federal autonomy, while today, for the first time, the rise of different provincial models is discernible. So when we talk of state-market relations in India, we are talking about state-market relations in many different states, not just at the central level.
DEMOCRACY AND INCLUSIVE GROWTH

The third axis is the legitimacy of the business class in this larger constellation of the ideological shaping of markets. At independence India had a very small embryonic domestic business class. There was the presumption that this business class would not drive economic growth and capital accumulation. However, it slowly grew under import substitution protection. By the mid-1970s, and increasingly after that, the domestic business class had grown to a critical size, allowing it to play a growing role in India’s economy. From 1991 until today there has been a wholesale replacement of the Nehruvian paradigm of an embryonic business class with the presumption that growth in India will be private sector-led.

On the cultural level, the private sector has become something new. Who would have thought years ago that big business and captains of Indian industry would become national icons?

The last axis is that state-market relations are shaped by a country’s orientation towards the outside world. India started off with a phase of export pessimism, so it was an import-substituting economy that was not integrated with the world economy. The country has now decided to rapidly integrate into the world economy. This has been a very self-conscious political choice. The drivers of India’s rapid integration into the world economy do not simply concern an economic logic around growth. Given India’s history, this is a remarkable shift.

**Dr Partha Mukhopadhyay, Senior Research Fellow, CPR, India**

Concerning the content of inclusion policies, we can make two broad distinctions: social and economic. As regards social inclusion, the axis of caste was very important, since in many parts of India this is still one of the axes around which actual and perceived oppression takes place. This kind of behaviour was made illegal, or unconstitutional, right at the outset. Strong affirmative action programmes for specified groups, called the scheduled tribes and scheduled castes, essentially because they were in a schedule to the Government of India (Scheduled Castes) Order, 1936 which had a list, or schedule of castes throughout the British-administered provinces, were also established. Legal remedies for social issues were also introduced; for example, a number of those castes were not allowed access to temples, and that was opened up, and the legal position of women, especially Hindu women, was quite weak, and that was addressed.

Economic inclusion has three broad elements. The first is the traditional aspect of redistribution, with land reform being the big issue in most countries. And then of course there is redistributive taxation: you take from Peter and give to Paul.

The second is a safety net. This includes the national employment guarantee scheme, something on which we spend roughly $9-10 billion a year, which guarantees 100 days of employment at a given wage to every household in rural areas. We have also established a public distribution system which tries to assure a supply of food grains at nominal prices – in certain states, less than two US cents for a kilogram of rice. We spend about $12 billion on this system, amounting to expenditure of about $20 billion on just these two programmes.
The third element of inclusion becomes much more salient when an economy starts to grow at the rates we have seen in India in the recent past, namely whether citizens are able to participate in the growth process. As an individual, do you feel yourself to be part of the story?

Regarding the political phases of economic inclusion, India began with redistribution. However, not much was done; for example there was no drastic land reform except in a few states. From 1967 to 1992, a kind of post-Nehru period, India’s approach to economic inclusion was largely through safety nets. It saw the establishment of a variety of anti-poverty programmes, including business funding schemes, self-employment schemes, food for work programmes, and employment schemes, all of which were devolved to various states in various forms.

As this process moved on, it was the middle class that ended up receiving significant support from the government by way of subsidies. Some of these persist today in various areas including higher education, consumer goods such as liquefied petroleum gas, public transport, and housing.

Over the past 20 years, as India moved into a growth story, economic inclusion has moved to participation. But this is a curious story, because participation is not happening as a result of state action. People are taking it upon themselves to demand ‘participation capital’, essentially education. This demand has been met with a private supply of English-language education varying greatly in quality across the system. You have schools which charge $1 000 a month, ‘normal middle class’ schools which charge about $200 a month, and schools which charge about $5 a month. So the private sector has come up with this huge spectrum of offerings to cater to demand across the income spectrum. I call this ‘private coping’ as a means of accessing participation capital, as opposed to state delivery.

On the issue of state-business relations and elite capture, India, over the last 60 years, has run a relatively tight ship as far as fiscal and monetary policies are concerned; it has been a relatively low-inflation economy, with double digit inflation regarded as political suicide. There are a number of issues surrounding our legal processes, including the rule of law, contracts, alternative distributions, and structures.

However, I would like to focus on what I call the ‘game-making state’, with the state essentially determining three things: the playing field; the players; and the rules of the game.

By ‘playing field’ the issue is which industries are allowed to compete. For example, even today private coal mining companies are not allowed in the Indian system, and defence and atomic energy could be added to this.

Moreover, formal-informal businesses is an important issue. For a long time, there were restrictions on the size of businesses that could operate in some sectors; for example, in textiles and garments you could not have a business that was above a certain size. That changed only about five years ago.
DEMOCRACY AND INCLUSIVE GROWTH

The informal sector is an integral part of the economy. About 35 per cent of the informal labour force is active in manufacturing, compared to about 20 per cent of the formal labour force. The figures for construction are about 15 per cent and about 5 per cent; and for trade, about 20 per cent and about 5 per cent. Most of the formal labour force is engaged in education, banking, and government, sectors where informal participation is relatively small. So the informal sector is not a separate group; it is not a basic livelihood story; it’s very much a part of the structure that delivered the 8-10 per cent growth rates in the recent past.

In terms of the players, the issue is ease of entry. In earlier years, this was regulated by means of licensing regulations. Today entry is largely unregulated, and therefore a free market. Of course, some limitations remain, largely related to participation of foreign players in specific sectors, and involve a competition commission, various regulatory entities, and so on.

As regards the rules of the game, what laws relating to labour, to environment, banking laws, etc. apply? The labour and the environmental laws are largely enforced. There are a number of things that are written at the union level or the federal level, but they’re enforced at the provincial level.

How has business responded? One big difference with the past is that, instead of asking for individual exceptions, there is now a broader demand for change in the rules of the game. New sectors are opening up, and markets are being merged, with telecom in particular being an interesting story. Obviously there are different interests; there are players who are in the market and playing from the inside, and others on the outside who want to come onto the field. This creates some tensions.

Businesses also responded to the new frameworks by partnering with government, largely in respect of infrastructure. Power plants, roads, airports, solid waste management, you name it, somebody has been trying to crank up a PPP story somewhere.

Businesses have also reorganised production around formal-informal links, and have relocated to provinces that implement laws at different levels of intensity. For example, Gujarat, one of the fastest growing states, has a 400-kilometre chemical corridor which is an environmental disaster. It compares quite well with the best environmental disasters you see in China.

Finally, business accesses different markets. Indian industry has done a lot of external commercial borrowing over the past few years.

Panel discussion

T N Ninan, Chairman and Editorial Director, Business Standard, India

I would like to make three broad points. The first is that, while the post-independence Indian state was ostensibly suspicious of markets, and tried to put down private enterprise because of the emphasis on state-driven activity, the substance of the relationship was one of great co-operation.
Even when the intention was ostensibly to restrict and limit private enterprise, large industries continued to capture the regulatory regime and exploit the situation. So the relationship was one of co-operation and co-option rather than confrontation.

It is important to understand how this has worked. For instance, the post-colonial approach to development and growth of being suspicious of world trade, and therefore focused on import substitution and domestic growth, was very much in the interests of the domestic entrepreneurial class. Indian business was quite happy to keep out international companies and have the Indian market for themselves. Whether it was licensing or import restrictions, or controls over technology and capital, all these measures helped the Indian entrepreneurial class to establish itself as a dominant force in the Indian economy. Therefore, whatever the stated intentions of the policy were, it fitted very well with the interests of the dominant class.

Furthermore, policy helped big business rather than small and medium enterprises. The most effective manifestation of this was the exchange rate policy, in terms of which the rupee was fundamentally overvalued for decades. The SME sector played a much greater role in exports than their share of domestic manufacture arguably warranted, while the big companies focused their attention on import substitution and domestic markets. The overvaluation of the rupee mitigated against those smaller export-driven companies because it made it difficult for them to compete on price in international markets, while the domestic market was protected with a very high tariff wall. So policy was actually helping big industry, and working against SMEs.

Similarly, the most rigorous phase of industrial licensing was introduced in the late 1960s when anti-big business sentiments were at their most virulent. However, if one looks back at which companies benefited most from the industrial licensing regime, one finds that the overwhelming majority of licences had been issued to the same top 20 business houses the government ostensibly sought to control.

So this was an intensely co-operative exercise, even if it did not look that way, and far more cooperative than confrontational behind the façade of working towards different objectives. The reform process was not led by big business, but was more state-led than anything else.

Furthermore, the role of the state has declined dramatically. In the 1970s and even the 1980s, 50 per cent of total investment in the economy under the five-year plans was through the public sector. This has now dwindled to less than 20 per cent, which tells you that the state sector was unable to generate surpluses, and the private sector became dominant. But even today, the state remains dominant in areas such as finance, energy, transport, and still contributes more than half of GDP.

The co-operative nature of the relationship between state and business is increasingly being expressed through state capture and crony capitalism, and even moving one step further into oligarchies, where the two interests do not merely collaborate together but actually fuse into one identity. One sees political parties and their leaders running large businesses, the heads of large businesses getting into
parliament, and much more, combining into a new trend which actually undermines well-regulated markets.

**Dr Sergio Fausto, Executive Director, iFHC, Brazil**

Brazil has a remarkably robust welfare state compared with other middle-income countries. The method pursued was to incorporate labour and the formal sector of society, with the informal sector kept aside until quite recently, say 20 years ago.

Following the adoption of the 1988 constitution – a remarkable milestone, because it was written after the return to democracy – we significantly enlarged the welfare state, incorporating groups and societies that had hitherto been excluded. Most of our social policies became universal. We have education for all children between seven and 14, and healthcare has been made universal. At the same time, the formal sector has continued to provide the financial basis of the amplified welfare state, so the capacity of the Brazilian state to redistribute income through public policy is presumably greater than India’s.

At the same time, the economic burden of the welfare state has detracted from our potential for economic growth, thus reinforcing the divide between the informal and formal sector of society. This is the Brazilian story in a nutshell.

So an important question is how India can have such integration between the informal and formal sectors? And how does that relate to the kind of welfare state or social policies you have in place in India?

**Fuad Cassim, Special Advisor to the Minister of Finance, South Africa**

When discussing formal and informal sectors, it is important for us to define exactly what we mean in the various country contexts. In South Africa, for example, the informal sector largely functions outside the mainstream economy.

As regards economic growth, it is widely understood that this is dependent on a variety of institutional factors. We recognise that the state has an important role to play in creating enabling conditions for economic growth. Its role is even more important in a highly unequal society like South Africa, where it has to help level the economic playing field. To some extent, this is no longer an ideological debate; states all over the world are playing that kind of role.

What is important is not the magnitude of state intervention, but its quality. This largely depends on the calibre of state institutions, and the calibre of the civil servants who make up the state. An effective and qualitative state can create enormous opportunities for growth, and inclusive growth as well. Equally, a dysfunctional state with poor capacity and significant levels of corruption can set a country back for several decades.
What characterises the South African state is that it is highly variable. Parts of the state function exceptionally well, while other parts have poor capacity, and present significant challenges. Since the transition to democracy, the South African government has created an environment conducive to growth by maintaining macroeconomic stability. At the same time, it has introduced a series of poverty reduction measures to ensure that marginalised people do not become even more marginalised as the economy grows.

**Vikram Doraiswami, Consul General of India to South Africa**

My first point is about inequality. In the 1980s the Gini coefficient for India was about 0.33. In the current period of greater economic growth, it has actually risen. This seemingly contradictory situation is underlined by the fact that close to 90 million people have been pulled out of absolute poverty.

I’m not an economist, and I don’t know how to reconcile these contradictory indicators. While giving greater play to market forces has pushed up rates of economic growth, it has also diminished the state’s capacity to intervene in developmental processes. How does one reconcile this with the original idea of the state providing services in areas where it was best suited to do so, such as providing rural infrastructure, and promoting the rural economy? This is an issue we need to address.

The second point is about co-operation and consensus-building. Seen from a historical perspective, this forms part of a wider theme of how Indian elites have sought to deal with challenges to their social position, whether by co-opting intermediate castes or classes in the formal economy or the political system. The question is whether this framework of co-option is still working in the face of crony capitalism, an activist media, and an activist judiciary. Are these processes beginning to fray, or is a new phase of consensus-building approaching? This is currently unclear.

My last point is a slightly seditious one about the shifting attitudes of business. The period of import substitution enabled us to create productive capabilities and capacities which gave Indian businesses the confidence to expand on to the global stage. When the government deregulated the economy in the early 1990s, protests came not only from the left but also from the right, including the Bombay Club of big businesses. Today, those same companies are out on global investment drives.

**Professor Robert Lawrence, Professor of International Trade and Investment, Harvard University**

Some fascinating points have been raised, including the issue of how states as well as businesses are legitimised. We have heard that, in India, the state initially derived its legitimacy from having brought about freedom, and – in some ways – because of this could spend a lot of time in a very nationalistic posture. We have also heard that business capitalised on this via a licensing system, and that, while the relationship between the state and large business was ostensibly an antagonistic one, there was actually a commonality of interests.
However, for how long can a state sustain its legitimacy on the grounds that it brought about freedom? At what point do people say, well, that’s fine and good but we now want growth and delivery? This is also a factor in the South African debate.

When we look back at the data now we see that India started to take off in the 1980s, but at that time people did not have the faintest idea that things were starting to improve. If you read the Indian press during the 1980s, or even the 1990s, it was astoundingly negative, despite the fact that there was a great spurt in growth. Why is this the case? The answer seems to be that when one starts with a reform process you hear from all the people with an interest in the status quo, and not from those people who will benefit in the future. They are still weak at that stage.

So when you’re engaging in reform in a free press situation, it is only when you start to deliver and build new constituencies who start to say that this system is working, and India is rising, that you can get a cumulative process under way. At that point the legitimacy of business has to change, because one is in an environment when it’s no longer about nationalism but about economic growth.

The country that did this brilliantly was Korea, where they changed the incentive structure for business. In the 1950s businesses were largely exploiting the internal market, but Korea began to realise that it had switch to exports. In this framework, business had to build a new legitimacy. This raises the question: how is Indian business currently legitimised? And is there a consonance between the efforts of the state and of business to build their legitimacy?

**Discussion**

The current Singh government, with the Congress Party at the centre, is the first to be re-elected since 1971, largely due to the reforms it delivered in the 1990s which are widely perceived as having benefited India. It is not enough to be a ‘Freedom Party’; now the electorate rewards those parties that deliver for them. However, state legitimacy in the eyes of the poor differs from state legitimacy in the eyes of the middle class. For the poor, it is argued that legitimacy comes from entitlement programmes like the right to food, education, and employment. For the middle class, legitimacy comes from the delivery of growth. For instance, the choice of telecom services has multiplied at a fraction of the cost and in cities like Delhi where power distribution has been privatised, tariffs have not increased.

However, domestic consensus on the need for further policy reforms is not guaranteed. Inequality in India has increased in recent years, despite active state policies promoting inclusion. State capacities may have decreased relative to rising demands on them, despite growing resources flowing from sustained economic growth.

Dr Mehta argued that it was very hard to identify the architecture of the Indian welfare state with a broad-based political movement such as organised labour in Brazil. Therefore – in some senses – the architecture of the Indian welfare state was much more top-down. So what is the Indian state’s game
Dr Mehta said the intention was to ‘ring-fence’ economic growth at about 8 per cent a year, and lock in increasing government revenues to fund further institutional reforms. For this reason the share of taxation to GDP was expected to increase from about 18 per cent to 24 per cent. This would give the state much more money and – assuming it was well spent – far greater capacity. Essentially, expanding the state would expand participation in terms of health, education, and social security. Much depends on maintaining high rates of economic growth; however, the sources and provenance of such growth are uncertain.

Over the past 20 years the story of India’s economic inclusion has been dominated by ‘private coping’ as a means of accessing what you could call, participation capital, notably in English-language education, but also the rapid growth of the informal sector. Professor Mukhopadhyay said the number of people in the formal sector in India had not grown relative to the overall growth of employment over the period 2004 to 2010. Obviously new jobs have been created and jobs have been lost, a lot of them in the public sector, and the mix of public and private jobs has changed, but there has been no net relative addition to formal sector employment during this period of high growth. Taken together with his breakdown of formal-informal labour market participation, these figures demonstrate that the informal sector is not a separate group in India but rather a central component of the economic structure that delivers the 8-10 percent growth rates that India has experienced in the recent past.

It was noted that in other countries if the informal sector starts to get big and compete with the formal sector, formal business has an interest in bringing the informal sector into the regulatory framework. So why isn’t formal business shouting more loudly about what they would deem unfair competition from informal business? Is it because the state doesn’t actually enforce its own regulations? Or is the distinction between formal and informal much greyer than in other countries?

Dr Mukhopadhyay responded that in many areas the informal sector in India are suppliers to the formal sector and consequently they are very competent vendors. You don’t want to mess up your vendors by increasing their costs.

Secondly, while you’re actually in the same final product space, you are addressing very different markets: ‘Today I can buy shirts for 100 dollars, 10 dollars, and 5 dollars and I have market size at each of those price points. There are spaces where the formal wouldn’t supply – the Tatas wouldn’t want to be caught selling shirts at 5 dollars though they did try and sell cars for a couple of thousand. They haven’t done a very good job with it. It’s a positive feedback loop where a large informal economy creates a very diverse consumer demand which is then met also by suppliers within the informal system.’
There are two interlocking loops. There is a broad loop that works to meet these structures within the informal system but if you took away the formal story, the informal wouldn’t grow as fast. If you took away the informal story, the formal wouldn’t grow as fast. So if you think of a Venn diagram there are spaces where the informal serves the informal. There are spaces where the two interchange and there are spaces where the formal serves the formal and there is enough mass in all these three spaces that essentially people are looking much more at expanding the size of the pie in each of these spaces rather than trying to share and keep people out of the system.

TN Ninan qualified this argument. He noted that the pressure from the formal sector on the informal sector is fundamentally to get rid of the tax advantages that the informal sector has. For instance, if you were selling branded air conditioners you would pay one level of excise duty. But there is a whole range of non-branded cottage industry air conditioning units that don’t pay those taxes and you could therefore buy a non-branded air conditioner for two-thirds of the price of a branded air conditioner. In the tobacco industry there’s a huge excise on cigarettes, which is a small part of the total consumption of tobacco; the bulk of tobacco consumption is through chewing tobacco or a local product called ‘the biddies’ and there’s no tax on those. So the entire focus of the cigarette industry is to get the tobacco tax broad-based.

If you move to a broad goods and services tax, everybody gets into the same net. So in his view tax disadvantages are the only formal pressure. However, the formal sector wants to get away from the labour laws that apply to it and not the informal sector. But that’s not to seek to put the informal sector at a disadvantage. It is to try and get rid of the problems that the formal sector has with rigid labour laws.

Several participants asked whether protecting domestic industry had enabled India to build capacity to compete globally. By contrast there is a view that in the key export sectors, particularly information technology services, new companies drove the process and were often led by people educated in America and elsewhere taking advantage of new conditions in India with the opening up of the licence Raj.

T N Ninan did not advocate the protectionist development model since in his view it led to inefficiencies throughout the system such that many of the biggest companies were not able to survive the shift to competition precipitated by the reform process. Professor Mukhopadhyay said that IT was not built by American-educated people, but by Indian-educated people who worked in America. IT was also built by many firms attracting underpaid, underworked, high-tech employees in government firms to come and work with them, and with India’s long-standing tax exemptions for exports. The latter were supposed to expire in 2010 but were extended in 2011 such that India has now created a regime of special economic zones ostensibly under the rubric of trying to encourage manufacturing, but over two-thirds are IT zones. Consequently, in Professor Mukhopadhyay’s view, the story of the initial growth of IT is a matter of chance, of unintended outcomes of state action, whereas the latter growth of IT is very much a product of state-business partnership.

Furthermore, it is not just the federal state that matters, although it clearly plays a significant role in Indian politics. Therefore many businesses remain concerned with arbitraging between regulations at
the federal and state levels. For example T N Ninan noted that prominent businessmen target prominent provincial politicians for party funding in order to exert influence over provincial policy processes and contracts. In his view state capture by business is intensifying.

Dr Mehta illustrated this point by noting that those very deep nexuses between the state and politics happen at the regional levels. However, at national level there’s a huge amount of corruption and manipulation of rules but the system still ends up looking okay from a regulatory point of view, because there are too many businesses and there are lots of different politicians who want their own crony capitalists. So in his view the best bulwark against regulatory capture is intense competition.

Professor Mukhopadhyay stated that in India you will always have a lot of ‘noise’. What that noise means at a given point in time is basically a matter of interpretation; in his view the noise so far has been relatively productive.

Dr Mehta noted that there is lots of anecdotal evidence about shifting attitudes towards business in India over the last 25 or 30 years. To him the most telling one concerns a database of applications to a scholarship fund for students from marginalised communities – the Dalits or ex-Untouchables; thousands of students apply for this. One question on the application form asks, ‘Who are your role models?’ Even in that section of the population, the farthest away from the economic participation story, the role models now all tend to be entrepreneurs.

Indian businesses have managed to ride a subtle nationalist wave. The growth of big business and their outward orientation and integration into the rest of the economy, is now seen as part of India’s rising great power status. Dr Mehta argued that society is often run not so much on the facts on the ground but certain interpretations of those facts. Thus over the last 25 or 30 years, as a consequence of colossal state failures in certain areas, including delivery of social services, India went through an ideological phase where, even if there wasn’t social legitimacy of business, state failure was a central part of India’s political imagination and business was the default option. However, this becomes a self-fulfilling prophecy because if you think a state is designed to fail, you create the ideological conditions for its own failure. So in Dr Mehta’s view the term that is at biggest risk in India at the moment is ‘public’.

Regarding organised business, Dr Mehta argued that the action is at different levels. One is the level of the formal associations. In his view that’s not the most interesting and important level of interaction in business and state relations. There’s a predictable formality to it. In the end business is restrained about criticizing the state. One measure of how meaningless that is, is that if you record every statement made by the Federation of Indian Chambers of Commerce and Industry (FICCI) and the Confederation of Indian Industries (CII) on every Indian budget in the last 15 years, they always like it. The real action in his view is where these organisations work within the margins of the regulatory structure. Big business does have significant power to influence politics – democracy is usually expensive, and big business is a very important source of election capital.
So what does big business exercise this influence for? There is some reason to think that there has been a shift towards paying money to get government to do the right thing rather than a straightforward story about simple exemptions. The reason for that is not that business became more benign. It’s simply because the business sphere is an extraordinarily competitive space.

There are growing concerns over corruption and the associated influence of powerful business interests in such processes in India. The country’s Transparency International ranking slipped below China’s in 2010 and in the wake of the telecoms scandal this year many international investors are regarding India with growing concern.

STATE AND MARKETS IN BRAZIL

Professor Amaury de Souza, Associate Member, CEBRI, Brazil

Brazil is a fully urbanised society: roughly 80 per cent of Brazilians live in cities, of which one-third live in metropolitan areas or very large cities. It has a population of 190 million people, much smaller than those of India or China. Brazil has basically completed its demographic transition, and will have smaller cohorts in the youngest groups in years to come. As a result, there are great concerns about the labour force by 2030.

Brazil achieved the kinds of growth rates India and China are experiencing today in the 1960s and the 1970s, precisely when most people moved from the countryside to the cities. So, just like India and China today, the country could take advantage of the substantial productivity increase brought about by urbanisation.

Brazil’s current challenges are those of having completed all the essential social demographic steps toward development but having started building a welfare state too early in the game. Brazil started to industrialise heavily in the 1930s, taking advantage of the Great Depression as well as World War 2 which blocked the supply of manufactured goods from abroad and cut off financing lines for imports into Brazil. At the same time, Brazil became the site for a sharp ideological confrontation between fascists and communists, which prompted Brazilians to focus on creating a national state and removing the incentives for the two radical movements. The first step was to set up a social security system. This started in 1914, and was consolidated in the 1930s. Rigid labour legislation was adopted at about the same time, and is still in force. Business and labour were organised from the top down, and this structure, described as ‘corporatist’, still exists today.

There are two separate but complimentary hierarchies for business and labour representation that work from the local level up to state-level federations and then to national entities. The labour courts operate between these two hierarchies; when the system was established, strikes were illegal, and the idea was that business and labour should settle their differences through the labour courts. Collective bargaining
States, markets, and enterprise

was introduced over time, but the labour courts are still there. They are very large institutions, and consume roughly 65 per cent of all funds allocated to the judicial system. So Brazil’s preoccupation with social peace from the 1930s onwards was aimed at preventing any kind of class conflict in the country.

This system generated sharp market segmentation, because it was not available to everyone; until recently, rural labour was completely excluded. Moreover, as in India, about 45 per cent of the urban labour force is excluded from this system, which defines the formal sector. Workers who don’t have a formal work contract are out. They now have access to social security, but mostly in the form of an age stipend. They are not represented by the labour unions, and can hardly make it into the labour courts. So they have no protection under the labour legislation or social protection institutions established for formal sector labour. This system conditions the attitudes and actions of the business sector.

This system was never dismantled, but another one was added around it, precisely during large-scale urbanisation from the 1960s to the 1980s, and while a military government was in place. Compared to those in neighbouring countries, our military government was very peculiar in that elections to the Federal Congress, State and Municipal Legislatures, and Executive Bodies of Municipalities, except in capital cities, were not discontinued. Presidential elections became indirect, and the only candidates were generals who were not permitted to stay in power or to wield any kind of influence once their term was over. Brazil is blessed with professional armed forces, but this period of military rule allowed the state to greatly increase its role in the economy.

Under the military, Brazil built a nationalised sector that was more extensive than those of socialist countries at that time. This included the establishment of state monopolies in, inter alia, steel, telecommunications, railroads, roads, ports, tourism, and banking.

Over time, this system became very unwieldy. First, it was based on import substitution, which was our version of the developmental state. Second, it was based on what we call the ‘triple alliance’ whereby the federal government would provide credit via public banks to domestic companies and ‘national champions’ that performed well at home and abroad, and of course to state-owned corporations. At the same time, because of technology, multinational business was invited in and treated in the same way as state-owned corporations and domestic businesses. Third, this was a very interventionist state, not only in terms of the economy but in all areas of social and political life.

So when this all came crashing down, thanks to a heavy reliance on so-called petrodollars and ensuing Reaganite monetary policies, Brazil went bankrupt, and this system collapsed.

As the system began to collapse, business began to rally against it as well, and started to create a whole new structure of representation. Independent business associations were established almost overnight. This was primarily sector-based, but included peak organisations such as Entrepreneurial Action. Business associations did not substitute for the corporatist structure. They coexisted. Some of the new
associations became instrumental in lobbying for pro-market reforms in Congress at that time. The old structure proved resilient, and at the same time started to adapt itself to the new environment, acting with more independence from the incumbent government.

As the country re-democratised, income redistribution became a central concern, because the demise of the developmental state had left Brazil with a few legacies. Two of them are worth noting. First, rapid industrialisation (under the military), during the phase of import substitution and in terms of the concept that it was better to enlarge the pie before dividing it up, had led to extreme income concentration. This was also partly caused by massive rural-to-urban migration.

The second was chronically high inflation, because this was how the government had financed the developmental state. Inflation turned into hyperinflation. Fortunately, however, after several failed attempts, the government managed to stabilise the economy, which changed the whole game especially for the two players we are concerned with: the state and business.

Prompted by the 1988 constitution, there was a surge in public spending by the state. Part of this came from entitlements handed out at the time which had to do with social security and social protection. Entitlements were handed out with no commensurate increase in taxes. Fiscal sustainability became a greater problem. That was made explicit when the economy stabilised and public expenses were no longer eroded by high inflation. The state then turned to borrowing money. When public debt became unsustainable, it turned to increasing taxes. From 25 per cent of GDP in the beginning of the 1990s, the tax burden went to nearly 38 per cent of GDP today. This is the highest tax burden in the hemisphere. Not even Canada, which has a self-conscious social welfare system, has that kind of taxation; taxes in the United States and Canada are about 30 per cent of GDP. Brazil’s dream is to become India – to pay 18 per cent in taxes!

So pro market reforms were prompted by this crash of the whole import substitution growth model, and they were very effective. At least for the two terms of office of President Cardoso a lot of ground was gained. First, he privatised a great deal of state businesses; a very long list and these privatisations more importantly were very successful, especially telecommunications. And Brazil became a major producer of steel. The business turned multinational. It was a successful intervention.

Second, Brazil moved to free trade overnight and that did a great deal of good for Brazilian business by way of a Schumpeterian kind of ‘creative destruction’ which destroyed inefficient business that had blossomed under state protection. This should be Brazil’s next step; to liberalise further to compete with China because our protectionism is making China an almost unbeatable competitor. So Brazil really needs to make the counter move which is not to close the economy, rather to open it further. Business will be under renewed pressure to reassert its performance and role in the country. They don’t like it but it’s coming.

From the viewpoint of labour, the major concern when trade is liberalised is the sluggish reallocation of labour and the costs for displaced workers, with the adjustment costs increasing with age. Prior to trade liberalisation, Brazil instituted unemployment insurance and increased its coverage as part of a broader
labour market reform in 1988. That reform also included a targeted employment subsidy and active labour market policies such as training and job search assistance. These initiatives have greatly reduced the impact of trade liberalisation on workers, thus accounting for the relatively low opposition from organised labour, at least when compared to its reaction to the privatisation of state-owned enterprises.

In many ways, the Lula government was a step back from the market reforms under the Cardoso administration. However, it did introduce a number of micro reforms, not unlike those in India, that do not touch on the more politically sensitive issues such as social security or tax reform but facilitate the operation of the market and of business. For example, there is a new bankruptcy law which has proven to be exceptionally well adapted and helpful. Property rights have also been reformed, which has revived the mortgage market. So the housing and construction markets are booming. This was a different approach, but just as important as the ambitious reforms of the 1990s.

While this has created a new situation, further reforms are needed. Public spending is still an issue, but the difference now is that resistance to tax increases are rising. For the first time, a business coalition was able to defeat the government. The government was trying to renew an existing tax, the so-called Financial Transactions Tax, and was defeated at the height of Lula's popularity when he could boast of having 70 per cent support in both houses of Congress.

This resistance to raising taxes will probably continue to grow. So it’s up to the state to reform itself, in four main areas. The first is social security. Brazil has two social security systems, one for civil servants, both military and civilian, and the other for the private sector. Civil servants retire on full pay, and the constitution gives them the right to increases in line with wage hikes to active civil servants. The private sector social security system – a pay-as-you-go system, subsidised and managed by the state – currently covers about 28 million pensioners, and the civil service system about 900,000 (at the federal level). The deficit in the latter is bigger than in the former, but in the longer term the most severe fiscal problem lies in the private sector system.

The Lula government relied heavily on real increases in the minimum wage in order to achieve pro-poor growth. However, private sector pensions are also tagged onto the minimum wage. So each time we increase the real minimum wage by one Real, the social security bill goes up by 108 million Reais. This means that real minimum wage hikes, which have been very effective as an anti-poverty policy, cannot increase much further (from 1994 to 2010, the minimum wage increased 150 per cent in real terms).

The second area is infrastructure. When increasing taxes was no longer an effective way of enabling the central government to meet its obligations, it turned to cutting investment expenditure, as a result of which Brazilian infrastructure is now in a shambles. Besides opening up our infrastructure to private capital, we also have to limit distributive policies in order to invest in it. The choices are very constrained.

The third area is education. All or almost all Brazilian children of school-going age are in schools, mostly
public schools, but the quality of their education is debatable. Not much can be done about this, because it will take generations to improve the quality of education, so we just have to continue trudging along the same route as in the past.

We still keep the public universities free. But entrance is subject to stern examinations so that only the few who have a very good high school education will get through, and high school education exists for the rich. Only one-third of the school age population in Brazil enters high school and these are the rich. So before Brazil moves ahead with slashing welfare subsidies, we should slash the subsidies for the rich.

The fourth is the incorporation of the informal sector into the formal economy. The informal sector in Brazil is defined by its exclusion from very rigid and restrictive labour legislation. However, this system has been sustained because a great deal of taxation comes from payroll taxes. So it’s difficult and expensive to employ people in Brazil. Despite this, some 15 million new jobs were created in the formal sector over the past eight years, at a current rate of about two million a year. This was not only in the service sector, but also the industrial and public sectors. However, the bulk of these jobs pay relatively low wages, hence the overall impact on payroll is more limited than in the case of higher quality, more stable, and career-oriented jobs. White-collar jobs with a formal work contract are still relatively scarce. Except for occasional political appointments of limited duration, jobs in the public sector are filled by passing a public examination, and are always covered by a formal work contract regardless of the level of occupational competence.

Be that as it may, the frontier in respect of stimulating inclusive growth is to erase the formal/informal divide by way of labour law reform and tax reform. Business is at the forefront of the thrust for administration reform; not necessarily reducing the size of the government, but making it more effective, and making it work for what citizens pay.

Pro-poor policies have reduced economic inequality in Brazil, in clear contrast with India and China. They are at the stage where Brazil was half a century ago when both incomes and inequality rose very steeply. In the process, Brazil became the most unequal society on earth. But this gap is being narrowed, and the poor are being absorbed. We now have to incorporate the informal sector into the formal economy, and hope that we will be able to keep on growing at the same rates as in the past.

Panel discussion

Joaquim Levy, Director, Bradesco Bank, Brazil

If one looks at Brazil over the past 15 years, one sees three steps or phases. First President Cardoso laid the basis. It was not only privatisation; for instance, one of the major reforms was in education, which for the first time became universally funded in a meaningful way throughout the country. While not as diverse as India, Brazil is a diverse society, with some poorer regions. So we tried to address these issues in a comprehensive and sophisticated way.
The opening of the economy is a common factor. It’s not by chance that the period from 1989 to 1991 were years of change in India and South Africa as well as in Brazil. A major external factor was the demise of Communism, which changed the dynamics in many countries. One could now do things one could not afford to do before, and this happened in all three countries.

In our case the major change was the opening of the economy and other reforms which were previously inconceivable. These reforms, combined with the reforms of the late 1990s, led to much more competition. Some major companies diminished in size and became less important; there was a lot of new money, and many other new factors which were reshaping the business sector in Brazil. This was the first period up to 2002.

Then we got the first president that came from the private sector. The previous presidents had been politicians, academics, or lawyers. Of course, Lula came from the side of labour, but knew first-hand what would work and what would not; how far you could push the private sector, and what the limits where. This was very important for policy making.

He did not want to introduce major reforms all at once because he knew from his experience as a union leader that if you do that, you just disorganise the whole economic fabric, and wind up with inflation. This was a core part of his strategy: step by step, he could do a lot more over eight years than if he tried to do it all at once.

The vice-president also came from the private sector – he was one of a new crop of business leaders who had come from very poor families but had become very successful. This gave them the ability, in a gut-feel way, to build on the foundations laid by the previous government for developing the business sector.

World economic conditions were also favourable, but they had this conscience so although this was a left-wing government, they pushed back a lot of the major reforms the Workers Party militants wanted, to ensure growth and the creation of a sustainable welfare state. This combination allowed Brazil to harvest good results, increasing the rate of growth and redistributing wealth.

As the economy started to grow and people saw new opportunities in the private sector, there was a sharp decrease of expectations for the public sector, accompanied by the idea that it should focus on basic public goods. This has been accepted by many people, including the new middle class. So the second phase was about freeing up the private sector to take advantage of the reforms of the previous period.

We have now entered a new period in which we may have to trim off a bit of fat from the last years of the Lula period. Given that we have addressed the welfare state as well as the private sector, the government now needs to focus on infrastructure, and to achieve success it has to attract both domestic and foreign investment which involves expanding the capital market. This is our current challenge; however, if business and government co-operate as they have in the past, we are well placed to address it.
The sources of legitimacy of both government and business are similar to those in other countries; as long as the government provides a minimum framework for business to increase the supply of goods and make them accessible to a broader range of the population, both sides are legitimised.

Dr Pratap Bhanu Mehta, President and Chief Executive, Centre for Policy Research

I would like to raise three issues. The first is the role of urbanisation. From an Indian perspective, it is very interesting that Brazilian growth was sparked off by large-scale urbanisation. One of the big puzzles about India is that there are high levels of conceptual and ideological disagreement about the desirability of urbanisation. In fact, several social safety net schemes have been justified on the grounds that they functioned as anti-urbanisation and anti-migration strategies.

The second concerns the drivers of creating a welfare state. The Brazilian welfare state emerged as a response to political contestation between the right and the extreme left. The Indian and South African states also have to respond with some kind of welfare architecture. The issue is whether they should do so on the back of a strong labour movement or corporatist bargaining system, similar to that in Brazil; or in the way in which it is being done at the moment, which is essentially top-down.

If you were to trace the ideological lineages of the Indian welfare state in its rudimentary form, you would tell something like the following story: in a democracy there has to be inclusive growth and you have to respond to the needs of the poor. But it’s very difficult to identify the architecture of that state with a broad-based political movement in the way in which labour was a big movement in Brazil. The architecture of the Indian welfare state is much more top-down. The left party is about to be decimated even further, and the question is whether this would be a contingent feature of citizens’ political choices, or whether there is something about the structure of the economy that produces that form of political mobilisation.

The third issue is about options for restructuring the welfare state. Some argue that the Brazilian welfare state needs to be readjusted. This has two aspects to it. The first is how states make these sorts of choices about the allocation of resources. At one level, what was said about Brazil is also true of India – we also lag behind China in terms of infrastructure and education. But the issue is, how do you get the timing right – when is it appropriate to invest in infrastructure? Is there a risk of doing so prematurely?

Second, and more interestingly, some would argue that the restructuring of the Indian state has less to do with the extent of welfare, which is large but not unsustainable, and more to do with the structuring of subsidies, particularly in respect of the elite. There seems to be two threats to the welfare state: excessive welfare, and irrational subsidies for the privileged. The issue is how much headroom one has to smooth out this stark choice.

HE Mr José De Sá Pimentel, Ambassador of Brazil to South Africa

The countries we are discussing are very complex societies. However, I do believe it is essential for them to co-operate in terms of foreign policy, and their actions in the international arena.
The world is changing rapidly and drastically. We somehow need to adapt to these transformations of the global governance structure. Therefore, we don’t have the luxury of remaining outside the process of discussing the rules that will guide the world community during the rest of the 21st century. We are all in the same boat in this respect, even though these are very different countries with their own specificities.

Lumkile Mondi, Chief Economist & Head of Research, Industrial Development Corporation of SA

For South Africans the role of the financial sector in Brazil has been very illuminating. Firstly, the Banco Nacional de Desenvolvimento Econômico e Social (BNDES), is seen as a very interesting model for South Africa’s development. The BNDES plays an important role in financing businesses but also as an insider, because it is very close to government through various ministers of finance who are periodically seconded to the bank to help implement the government’s national agenda. A second interesting feature is Brazil’s innovative funding, such as the fund for social inclusion. However, these aspects are being completely misunderstood in the South African developmental arena.

Brazil is very popular within the South African government, firstly because Lula came from the labour movement. The South African government leans heavily towards labour, so Brazil is an interesting case study for them, and its ideas around state-owned enterprises and development finance institutions have received close attention. For example, in the case of development finance for industry the notion has arisen that the Industrial Development Corporation (IDC) could replicate a lot of what BNDES has done. But I would argue that these institutions function in very different contexts, and very different financial sectors. Among other things, the Brazilian financial sector has very high interest rates compared to South Africa.

Secondly, given Brazil’s history of hyper-inflation, its private sector does not provide long-term funding, which the South African financial sector does. Therefore, the IDC cannot replicate the role of the BNDES of extending loans in competition with the private financial sector. Any business here that needs funding should go to the banks.

Development financing institutions should fund riskier projects which experience market failure – in other words, which the private financial sector are unwilling to fund – or at least assume some of the financial risk. However, these issues are completely misunderstood in South Africa. The opening of the Brazilian economy under Cardoso was a fascinating period for us, because it came at a time when the South African government under President Thabo Mbeki embarked on similar policies. We seemed to share the idea of involving business as a development partner in ensuring that inefficient state-owned enterprises were improved, and giving the private sector the space to operate where it could do better.

This also involved ensuring that dominant state-owned enterprises were to be fragmented to bring efficiency and new players into the value chain. For example, in the case of power, the idea was to have a generator, a distributor, and a transmitter. However, all those ideas were thrown out of the window
as political differences within the ANC-led alliance sharpened. In many cases the South African state is trying to do things that seem to favour it without looking at the whole pie, and then considering what it could gain from cutting it up.

The Brazilian experience teaches us that sequencing reforms and staying the course are vital in order to make a dent in inefficiency, unemployment, poverty, and inequality. However, the issue is how this could or should be achieved. In Brazil, this was done via a co-operative or partnership approach which was made possible because Lula had previously worked with business, and tried to forge a partnership between the private sector, the public sector, and broader society. In South Africa, by contrast, the state wants to control everything; it wants to do everything on its own, because it believes it has all the solutions. Consequently, the private sector is left in the cold as the state is not engaging, and where it engages it is prescriptive, as is the case in the current debates on nationalisation or land reform.

Discussion

Dr Sergio Fausto noted that thanks to Cardoso’s strong leadership, the markets regarded the reform programme as credible and therefore sustainable. In order to retain market confidence in his leadership and thus avert a major financial crisis at the time of his first successful election, President Lula publicly supported the Cardoso reforms. Thus leadership from the top played a key role in initiating and sustaining reforms, in the face of major domestic opposition. Indeed, labour was the last to be included in the Cardoso reforms.

In the 1980s no-one would have anticipated the current reality, which was a testament to the success of the reform programme pursued under both presidents.

Whilst there was some debate over the extent to which Lula really embraced the entire market reform agenda, there is consensus that his administration continued with incremental microeconomic reforms such as the new bankruptcy law, and establishing property rights for urban land. The new bankruptcy law, which is exceptionally well-adapted and helpful, provides ‘enhanced protections and flexibility for debtors in financial distress to reorganise while continuing to operate their businesses’. This has made it easier for creditors to retrieve houses in case of debtor defaults thereby fuelling the mortgage market in Brazil, which has led to a housing and construction market boom.

Furthermore, Brazil still has very high rates of social mobility, which Professor De Souza argued is the source of Brazil’s entrepreneurial spirit. José Alencar Gomes da Silva, Vice-President of Brazil from 2003 to 2010, represents a prime example of an extremely successful self-made entrepreneur. Da Silva dropped out of primary school to help his father with the family business, which in time he managed to turn into the leading textile manufacturer in the country. José Serra, mayor of São Paulo and Governor of São Paulo state, was born to a semi-illiterate fruit vendor from Italy who managed to send his son to college – the first in his family to receive a college education.

To some extent this may explain Brazil’s recent successes with reducing inequalities. However, part of the credit also lies with recent government policies such as the famous ‘Bolsafamilia’ welfare system.
Brazil has combined job creation with wage increases, and macroeconomic stability. Dr Levy noted that in the early 1990s Brazil’s loans to GDP ratio was about 35 per cent. By 2002 this figure had decreased to less than 25 per cent, which included public and private lending. However, since then the ratio has grown substantially to between 40 per cent and 47 per cent. Importantly, a large portion of that debt is attributed to personal credit. For Dr Levy, these figures go a long way in explaining how Brazil manages to sustain increasingly high wages and growth in employment. Furthermore, the welfare state has expanded, financed through debt and increased taxes, extending credit, enlarging benefits, and incorporating people into new entitlements. The sustainability of these changes is in some doubt.

In Dr Fausto’s view, Lula took reform out of the agenda and the message was conveyed to society and to politicians that Brazil had reached a ‘perfect formula’ of growing higher and higher forever without rocking the boat, accommodating every sector of society within the public budget. President Rousseff inherited this delusion. The interesting question is can she deal with this political dilemma, being an outsider, not a politician, being a newcomer in the Workers Party, and not having Lula’s political weight? Hence further reforms may be inhibited. In addition to the increasing debt burden, are severe labour market rigidities, which have been present in Brazil for decades and have yet to be addressed. For example, trade unions still enjoy closed shop agreements. President Lula recently tried to revive the corporatist mechanism by creating several tripartite fora. In Professor de Souza’s view all of them were undeniable failures.

Both business and labour have the right to impose levies on everybody within a jurisdiction, regardless of whether they are unionised. Workers in the formal sector pay one day’s pay per year to the union that formally represents them and most of them don’t know that they are represented by a union. They don’t have to because this is a devolution of public power to private bodies. In the business associations also you will receive notification to pay levies every year from a business association you don’t know about.

So the corporatist system, labelled by Professor de Souza as a ‘structure of privilege’, has remained more or less intact. South Africa’s experience with corporatism, strong labour protections, and welfare state expansion is more recent, but the parallel is nonetheless striking. The Brazilian corporatist structure arguably explains why the informal sector, particularly in the rural areas, has expanded rapidly in recent years. This phenomenon parallels the Indian experience; in both cases the informal sector has flourished partly in response to structural labour market rigidities.

Nonetheless, microeconomic reforms, at the prompting of business can and have played an important role. The São Paulo Chamber of Commerce, which is a private association, has been in the forefront of pushing for reform that affects small and medium size firms since the 1980s and has focused attention increasingly on bringing the informal sector into the formal economy. They drafted a law that, with the help of the Ministry of Finance and especially the then Minister of Finance under Lula, passed
Congress. It’s called the Creation of the MicroEntrepreneur and is directed toward roughly 12 million self-employed or people working without a work contract, which adds up to about 45 per cent of the working age population in São Paulo. Since the law went into operation in 2010, some 4.5 million registered businesses have been established. The reason is that now anyone can walk into a government office and request business registration without having partners, without being forced to keep an accounting system, without having a place of work, and without needing to provide an address. You can do it through the internet in the state of São Paulo. In addition to that, taxation, which had already been simplified for SMEs, has now been further simplified for the micro-entrepreneur. In all, they pay one small flat tax. That covers everything including Social Security.

In Dr Levy’s view, since the beginning of 2011, the newly-elected Brazilian government has managed to make important adjustments, notably in reducing the pace of growth of the minimum wage. This reinforces the election slogan that ‘we were elected in a plan of continuity with change’. Also the government was able to convey the need for further fiscal adjustment. So 2011 is a year of real readjustment and maybe selective reforms, particularly in social security and notably state pensions and minimum wages, education, and funding infrastructure.

STATE, BUSINESS AND MARKETS IN SOUTH AFRICA

Since the workshop took place in South Africa, with a largely South African audience, this session was structured in a different way. A high-level panel was assembled, with each panelist addressing specific questions related to the overall theme.

Is there a coalition for rapid and inclusive growth in South Africa? If so, what are the respective roles of business and government? If not, why not?

Tshediso Matona, Director-General, Department of Public Enterprises, South Africa

The relative roles of the state and business are one of the longest-standing issues in economics, which still attracts much intellectual interest. It’s obviously an ideologically laden issue, which has been historically contested from two broad traditions: Marxist and liberal. But a new context has arisen, shaped by the collapse of socialism in Eastern Europe; the collapse of the Washington Consensus; and the near-collapse of the financial system on which market capitalism has historically been based.

This new context gives us a chance to establish a new consensus within which to locate policy and strategies for economic restructuring and development. Thankfully, one of the principles that has survived is a recognition that the state does have a role to play in the market, and can be powerfully transformative. This increasingly expanding pragmatic space straddles the historical ideological traditions, and makes it possible to forge new approaches to tackling the problematic of economic development.
However, when we come to the South African context the state and business have had a degenerative mistrust of each other. Business has tended to have a knee-jerk reaction of protecting current assets and rights in a situation that requires it to be a lot more open to new ideas and taking risks so that we can seriously engage with the challenge of transformation in our country.

This has come at a cost of a strategic and co-ordinated partnership for transformation and development in order to address problems of poverty and unemployment. Since 1994 there have been attempts to forge such a partnership, with the Growth Summit as one example, and various working groups that were convened under President Thabo Mbeki’s administration. But these have not gone far enough and have not gained sufficient gravitas, partly because of unfulfilled commitments.

My central thesis is that the government, informed by the perspective of being a developmental state, has been a lot more diligent and proactive in articulating strategic visions and programmatic initiatives for realising the country envisioned in our constitution; be it the Reconstruction and Development Programme (RDP) right at the beginning of our democracy; the Accelerated and Shared Growth Initiative for South Africa (ASGISA) about five years ago; the New Growth Path and Industrial Policy Action Plan; and so on.

In fact, rather than being anti-business, as critics claim, the notion of a developmental state is a powerful invitation to business by government to partner strategically with the state towards a common South African future.

The implication is that the economic policy debate will not be too fruitful if business continues to focus obsessively on contesting the ruling party’s and therefore government’s commitment to a developmental state as its strategic perspective and organising paradigm for its policies and programmes.

In fact, all the main political parties propagate at least an interventionist or active state, and the economic policy debate should be decided on the grounds of which party proposes the most progressive and inclusive impact on our society.

In fact, the vacuum resulting from the lack of strategic co-ordination between the state and business has created a mechanism for state-business relations in which particular relationships or perceptions of relationships have come to play a prominent role. In the absence of a well-defined strategy for engagement, this space is being occupied by suspicions of preferences, special and non-transparent relationships, and so on.

Whether these suspicions are correct or not is not really the point. The point is that there is a gap which has been filled by tendencies that are obviously open to question. So we desperately need a national consensus on the standards and norms for governing this relationship.

I do believe there is a coalition for inclusive growth because the business people I interact with, as individuals and through their organisations, agree that the status quo is untenable, and that the state
and government cannot be left to address the challenge of development on their own. The New Growth Path, the latest expression of a programmatic vision of our future, creates a new space in which to approach these issues in fresh ways.

Given that it deals with our state-owned enterprises, the Department of Public Enterprises can make a meaningful contribution in this regard. We need to involve the private sector, in order to create new value that can advance our society and our economy.

**What is the relationship between business and growth?**

**Mike Spicer, Chief Executive Officer, Business Leadership South Africa**

As everyone knows, South Africa developed through the discovery of diamonds and then gold. The mines were the vehicle for industrialising the country. Post-1948 we had a very mixed system of government, in fact a form of national socialism, under which the market existed despite, not because of, the political system. This meant that when we transitioned to democracy, almost 50 per cent of fixed assets were situated in the public sector. The size of the state sector at that time is not always recognised.

Contrary to expectations, the ruling coalition in the 1990s was a liberalising and reforming one which took a number of important steps to open up the economy. Also, tariff liberalisation meant that productivity and competitiveness began to improve. This, coupled with South Africa’s re-entry into the global economy, led to substantial changes in the structure of various markets and the performance of the economy. Growth improved from 1 per cent a year at best to 3-4 per cent a year in the 1990s and 2000s.

From the private sector point of view we noticed a decline in the impetus to reform early in the new millennium, and certainly from about 2004, under the previous president, a desire for a ‘developmental state’. So this theme was not introduced with the Zuma administration – it was already there.

At an abstract level, there is cohesiveness between the public and private sectors in terms of national goals (high growth, more employment). The real point of debate is how this should best be brought about. Here we take a less theoretical approach and we find ourselves puzzled by the content of words such as ‘developmental’ and ‘transformation’. What exactly do those words mean?

We regard the policies of this administration as incoherent. We have a new growth path which in broad terms elevates the need to create employment to a national priority of the first order. We share that goal, because what distinguishes this economy from all other developing economies is our very high level of unemployment. And that is a source of poverty and inequality. This also answers the questions about the Gini coefficient – if 30 per cent or more of your population is unemployed, you will have a very high Gini coefficient.

However, if you have a ruling coalition that straddles every conceivable ideological position between unreconstructed Stalinists on the left and rampant free marketeers on the right, by definition you will have difficulties with policy coherence. And so, while we set ourselves the goal of creating five million
new jobs over the next few years, we also proposed amendments to labour law that will, at a stroke, abolish industries that have been painfully built up, and remove a few million jobs. These proposals speak to a static, mechanistic view of economies that might have been obtained in the white collar/blue collar 1960s but certainly has no relevance to the dynamics of a modern industrial and very open economy.

We are taking on very significant social commitments. Proportionally, we are probably a bigger welfare state than Brazil. Every worker supports three unemployed people, so there are 15 million people in the welfare system, increasing rapidly towards 20 million. And in terms of tax to GDP, we are heading for 30 per cent.

Despite this, we have on our slate proposals for a national health initiative, more social security, and free education. We're talking about nationalising the mining industry. We have a mining industry that has the most potential in the world, but has grown the slowest of all the major mining jurisdictions. This may be caricature, but we are running a very high risk of becoming a high-cost, high-tax, high-welfare state combined with low growth, low productivity, low competitiveness, and low employment. By contrast, we urgently need to define the practical measures by which we intend to achieve more labour-intensive growth.

We can form a coalition of the growth-willing. What we can't do is to have this endlessly empty debate about whether or not we're committed to development or transformation. These are empty concepts. They can only be expressed in very clear, prioritised, and sequenced goals that speak to the capacities of the state. In this respect, we've heard a lot about market failure in this country, but rather less about the significant failures of the state. To be a bit naughty and provocative, as one wag recently put it, before we have a developmental state, could we please have a state?

Having said all this, everybody in the public and private sector accepts that the current model is not working, and that we need to change, and it is in that spirit that some new encounters between the public and private sectors are about to take place.

The system of business and government interchange is certainly not well developed. We will meet for a formal structured discussion in a week or 10 days' time for the second time only in more than two years. That tells you something about the relationship, which has in fact been characterised by a lack of trust.

So, notwithstanding its diversity, the private sector accepts that we cannot continue as we are, and need to make some changes. The opportunities certainly exist, despite our legacy of apartheid and racial divisions. But the policy signs are confusing, and don't really speak to a clear set of growth-oriented priorities.
**Is there an enabling environment for entrepreneurial capitalism?**

**Futhi Mtoba, Chairperson, Deloitte South Africa, and Chairman of Business Unity South Africa**

There is a clear acceptance, both locally and globally, that the private sector is the engine of growth and prosperity in any country and through the revenues it generates it is the source of fiscal revenues for the state. Similarly, there is acceptance that the role of government is that of creating an enabling environment, performing its regulatory and service delivery role, and employing a number of people.

If one were to ask whether the South African environment is conducive to entrepreneurship, one has to look at our sound macroeconomic policies and legal framework. The regulatory environment still presents some challenges, particularly if you look at the key sectors that need to create new jobs.

We still have too many regulatory impediments. South Africa needs to look at how you make it easy for entrepreneurs to get out there and do their thing. Much can be done in this respect.

**How legitimate is South African business?**

**Mark Cutifani, Chief Executive Officer, AngloGold Ashanti**

The purpose of business is to deliver goods and services to satisfy the needs and wants of society. The objective of individual business people is to meet those needs and wants as efficiently as possible, charging a price that exceeds the cost of delivery but is still low enough that they will be invited to repeat the service. Not many people understand that this is fundamental in terms of the success, sustainability, and continuity of business in society.

The role of politicians is to provide a societal framework that enables the efficient delivery of goods and services in the context of ensuring that the minimum social requirements of all members of that society are met.

As one would expect from time to time, the objectives of business people and politicians will conflict. How we resolve those conflicts will have a bearing on whether business and politicians are considered to be legitimate in their respective roles.

Talking from the perspective of business, commerce has been around since antiquity. In this broader context, business goes beyond legitimacy; it is essential to the functioning of modern societies. This is not understood in South Africa. Business leaders must help to redress that imbalance, or supply that missing ingredient, in our national debate. At the same time, business doesn’t always fully appreciate the role and responsibility of politicians. We have a responsibility to listen carefully and understand the meaning of transformation, and the role we should be playing in terms of that process of change.

Therefore, when considering the legitimacy of business, three questions are relevant. First, do we provide goods and services in a safe and efficient way, such that we fit in our broader social context? As South African business, we still have a long way to go – as in most economies we have pockets of excellence, but as a group there is much we can do to improve our relevant competitive positions.
Second, are we engaged in constructive debates about how society functions? Are we a voice and a mechanism for the creation of a better South Africa? We are trying to find our voice, but whether we have that right is the subject of various relevant debates.

Third, are we accountable, both individually and collectively, for our behaviour in the context of creating a new South Africa? Business Leadership South Africa has just had a debate about a code of conduct, and the most contentious part was, what do you do if somebody doesn’t follow it? So we are starting to talk about collective accountability and individual accountability in the context of society.

We are still developing and building the post-apartheid era. The legacy of the past is still with us, and dominates our landscape. Business has a lot to answer for in terms of the way it behaved. The challenge for business is to reconcile the past with how it manages the future. However, if business is not included in every action and every step South Africa has a pretty grim future.

Encouragingly, government has acknowledged the centrality of business to growth and development. This was done in the New Growth Plan, and certainly in subsequent discussions. This is a major step forward, but in my view we’re only still scratching the surface.

It is also remarkable to witness the debate on the nationalisation of mines. Even COSATU and the South African Communist Party recognise the role of business in creating decent work across the country. They both understand the potential danger that nationalisation represents to the future of South Africa and its citizens, which is another measure of the legitimacy of business in the minds of key participants in the South African economy.

The access that business has to government is as strong as any I’ve seen in the 25 countries I’ve worked in until now. However, access does not guarantee influence. Our influence needs to be developed to such an extent that we have a more meaningful impact on policy formulation. I believe the members of the tripartite alliance have done a better job in driving the policy agenda. The challenge for business is to become a more influential voice in broader policy debates.

It is incumbent on business to adopt a partnership approach with government, to support it both in terms of formulating policy and the ability to execute it. The difference between strategy and execution is that strategy is a good idea, but execution is actually getting something to happen on the ground. And this, I believe, is what management and business can bring to the party to help the government change our society. Until we are trusted to provide input, and be a partner, the legitimacy of business will always be questioned. This is a key issue in terms of demonstrating that business has a legitimate voice in shaping the new South Africa.
What does South Africa have to do to be a successful developmental state?

Andile Sangqu, Executive Director, Xstrata South Africa

The South African state has to be conceptualised in a multidimensional and holistic way, so that it can engender comprehensive freedoms. South Africa may be in a better position than most late developers to construct a democratic developmental state. This is because, even prior to the global economic crisis that led to the resurgence of the state across the globe, the ruling party and government had recognised that addressing the developmental challenges facing the country – including growing the economy; reducing the high rates of poverty, inequality and employment; and improving the livelihoods of all South Africans – required a developmental state.

The challenge lies in designing appropriate institutions, and formulating and implementing appropriate policies. The South African government is one of few governments in the world that has committed itself to constructing a developmental state, as confirmed by President Zuma in his state of the nation address for 2011.

However, merely recognising the importance of a democratic developmental state in addressing our economic, social, and institutional deficits is not enough. The litmus test is the desire and ability on the part of government to create a competent administrative apparatus, and for political leaders to have the political will to ensure that the necessary resources are deployed. This also requires the forging of programmatic and reciprocal relationships with trade unions, business, community organisations, and other relevant entities.

Investing in our job creation capability will be a key measure of success. This will require some form of state intervention, and this is where companies and trade unions, in collaboration with the government, can look to formulating a new social contract.

South Africa has seen a variety of national growth strategies over the past 15 years, including the RDP, GEAR, the Jobs Summit, the Growth and Development Summit, ASGISA, JIPSA, and the recent Economic Growth Plan. The policy approach entitled ‘Framework for South Africa’s response to the international economic crisis’ dated 19 February 2009 represented a unique partnership approach agreed to by the social partners.

The challenges for business to earn and retain a social license to operate in a society with a widening Gini coefficient, underpinned by a historical context of racial oppression, are unique, immense, and urgent. The focus of these challenges is even more pronounced in the mining sector. This is a new and emerging business risk, and business needs to be far-sighted and act in collaboration with government and our various communities in order to address it.

South Africa has the highest level of unemployment of all upper middle-income countries in the world, and also one of the highest Gini coefficients. Furthermore, it faces a huge education crisis in the context
States, markets, and enterprise

of global competition. This means that inequality is being transmitted to the next generation as the most poorly performing schools are in the townships and rural areas, where many other factors serve to disadvantage young people. In addressing the question of what can be done, it becomes clear that central to an understanding of the South African democratic state is a consideration of its capacity to intervene in the national development process. A country’s economic governance reveals a great deal about its development orientation. The South African state needs to ensure that it develops its capacity to formulate and implement its development goals in a way that is authoritative and also ensures that it improves economic performance.

Ensuring a job-rich growth path over the next 15 to 20 years will require attention to the following priorities: going back to basics in terms of education; relevant and inclusive skills development; developing the capacity of institutions to formulate and implement policy; and ensuring that we have a new social compact between business, labour and government.

What is the nature of the relationship between the state and business in South Africa?

Ann Bernstein, Executive Director, CDE

I would like to raise five issues. First, who is business in South Africa? We tend to talk about it much too loosely; very often, we’re talking about big business alone. There are other kinds of businesses, which need a louder voice. CDE recently interviewed 25 entrepreneurs in Soweto asking what prevented them from increasing the size of their operations. What struck us was that none of them had ever heard of any business organisation, whether the Johannesburg Chamber of Commerce and Industry or NAFCOC.

So the nature of business and its organisational effectiveness at all levels are vital issues. Its capacity to interact on policy and other issues are directly affected by the strength of collective organisation.

My second question concerns the role of the state. Many development theories, especially those developed in the global North, tend to assume that states have a lot of capacity. I’m not one hundred percent sure how different people in South Africa view the notion of a developmental state, but we do know that the current state is not very effective. I agree with Fuad Cassim that parts of the state work well, even outside the Treasury, but this is very uneven, and many parts of the state are almost completely ineffective. This impacts on poor people’s lives far more than middle-class people. It also dramatically affects our prospects for higher economic growth and the ability to deliver the infrastructure that is vital for expanding exports and access to markets.

One of the things the entrepreneurs in Soweto told us is that good infrastructure in their neighbourhood would make an enormous difference to their prospects. Frankly, when the state can’t run existing public enterprises very well, and then wants to create more, it’s hard to take it seriously.
My third point is about the legitimacy of business. We heard earlier today that entrepreneurs in India today are regarded as heroes. This is certainly not the case in South Africa. The causes are complicated, and the history of apartheid has not been conducive to conferring this kind of status on our business leaders.

On the other hand, when presidents Mandela and Mbeki accepted the market economy as the key foundation for South Africa’s economy, this was an elite understanding. I don’t recall a democratic politician going to any city, region, or small town in South Africa and saying, let me explain why market economics will be the right way for South Africa, and why private enterprise is the best approach and the best way to help us get out of poverty as a nation.

So we’ve had a failure of leadership about acceptance of the market economy from the government and the ANC. We’ve also had a failure from business (companies, leaders, and organisations) who have not communicated effectively about what successful companies and competitive markets can contribute to the public good.

Fourth, the business sector in South Africa needs to be much more strategic, and needs a more effective set of voices. We’ve had various proposals from the state, the ANC, and other role players about how to grow the South African economy. Business leaders have vision, but not enough content, and too many business people react in a knee-jerk way in terms of, ‘we know what’s good for South Africa, and I will tell you what I was thinking in the bath last night’ rather than making solid, practical suggestions about how we should move forward.

On the other hand business people have not been encouraged to speak out; instead, executives in business have had their patriotism questioned. Nonetheless, business needs to be a much more effective actor in the public arena. It should invest far less money in ‘guilt’ or ‘nice to do’ projects, and far more in promoting the longer-term interests of their companies and the country.

My last point concerns the fact that when people talk about the state and business, they tend to talk about companies, and when business and government meet, they often talk about how existing companies could help with development. I am far more interested in how market dynamics can help South Africa deliver and this will require an expansion of the existing business community in many diverse ways.

We need to move away from business largesse and business expenditure on often well-intentioned but isolated projects to a focus on opening up markets, so that competitive market processes can deliver much more effectively. This will be far more sustainable in the longer term.

When 15 per cent of learners in very poor communities are attending low-fee private schools, this has far more impact than business organisations or business leaders saying, I will donate a person, or donate some money to help the state, or ‘adopt a school’. We need far larger and more sustainable processes, which comes back to market economics, and communicating much more effectively how markets work already to help poorer South Africans, and what needs to be done to ensure greater market delivery and access to all sectors of our society.
Discussion

The notion of South Africa being a ‘developmental state’ is highly contested. Michael Spicer noted that while we could stick with the model that the state does everything, our competitors are showing us a different model. Brazil has privately owned and privately concessioned ports. In India the private sector is a much more substantial participant in the infrastructure programme. By contrast, the South African government’s infrastructure programme accords the private sector the ‘magnificent sum total of 5 per cent’. We have to be much more ambitious, otherwise we won’t get jobs.

The terms ‘developmental’ and ‘developmental state’ were robustly questioned. Some participants viewed the notion of a developmental state as a symbol; because of the diversity of the coalition in power, symbols are needed to preserve solidarity. The ambiguity contained in symbols lends itself to such solidarity because the people on the political left, middle, and right will go away with their own ideas of what a developmental state actually is. For those on the outside, however, symbols are problematic because they are imprecise and viewed with suspicion. For many participants it was argued that it is necessary to move beyond ambiguity to more concrete ground where conversations centre on specifics rather than fear-inducing symbols.

Professor Berger countered by observing that the question is not whether you have an empty symbol. Everybody has an empty symbol from Obama to Mao Tse-Tung. The question is, what do you fill that emptiness with? What are the concrete policies subsumed under that symbol? Every politician comes into power with some kind of coalition; he cannot please all. Sooner or later he has to betray somebody. And by definition the only people you can betray are your friends.

Ann Bernstein referred to the ‘developmental state’ as not just a symbol but also a code for greater state intervention, encompassing a debate about whether to nationalise or privatise; whether the state should be running the ports and the railways; whether the state should be the key player in the electricity arena. That debate – in the context of a very weak state machine and performance record – was seen as part of what is holding the country back from increased economic growth and development.

There was also some concern that the notion of the ‘developmental state’ was code for the black/white divide in South Africa; in other words that a black government would favour black business over white business. Lumkile Mondi argued that this dynamic is reinforced by a common perception in the ruling alliance that (white) business is on an ‘investment strike’, which in turn legitimises state-led development ideologies since business is regarded as either incapable of delivering growth or deliberately sabotaging the economy. He noted that these undercurrents are fuelled by the growing power and legitimacy of the ‘African capitalist class’, which unfortunately is also associated with rapidly-escalating corruption linked with the access to power enjoyed by favoured business leaders in South Africa.

Tshediso Matona responded that within government there are a lot of people who will acknowledge
that things could be done differently, we can work a lot more efficiently, and that we do need to take some hard decisions. The notion that a developmental state is an entrapment that almost immunises us from reality is limited. A developmental state is an aspirational notion; the reality is much messier. In his view it is not possible to simultaneously obtain markets that work efficiently, a state that is capable, and outcomes that are neat in South Africa's situation. Therefore, we have to work with this messiness for a while whilst looking ahead, carving out space where we can work together to bring about meaningful changes. If we get stuck saying we are not going to really be partners until we are satisfied that this is a state that is effective we’re going to lose time. The key therefore is to plunge in and develop a minimum agenda. What are the things we can do where we don’t have to abandon our fundamental beliefs? In Matona’s view the government’s Growth Path begins to propose some of that.

Mark Cutifani noted that the mining industry has contracted in the last five years by some 10 per cent whereas our major competitors have grown 30 per cent. If you say to a mining company, ‘I want you to invest in the future and by the way you have to sell 26 per cent of the business’, then there aren’t too many mining companies interested; these are global companies investing in those businesses. In mining we’ve lost up to 200 000 jobs in South Africa and every person that has a job has 10 dependents. So that’s two million people who are missing out because of this inconsistency and uncertainty. Therefore he hoped the Growth Path document was ‘Draft 1’. Because if we don’t make choices between growth and some of the other policy priorities, we will not grow, and if we don’t grow, then many of the other objectives we set ourselves as a society will not be achieved. Internal coherence in terms of the policy setting for the country and really coming to grips with key choices is essential.

The new Growth Path document talks about trade-offs, but what are the key ones? Professor Lawrence suggested three. First, wages versus jobs. It could be that in order to achieve South Africa’s employment goals, we will not be able to achieve all of our goals about desirable wages; but we are in denial about that trade-off.

A second hugely painful trade-off is between redistribution and growth. This could be denied but the fact is that both demands have to be satisfied. The nature of a trade-off is you don’t go fully into one or the other; these are two desirable goals. But if you don’t accept there is a trade-off, you’re in denial. Yet that’s how you keep your political coalition together; don’t accept the fact that there is a trade-off.

The third trade-off is between helping people who are poor through welfare and consequently creating disincentives. If someone is not working, we want to support him. But in doing so, particularly if you don’t have a lot of good jobs available, disincentives to work are created. So the really creative thinking has to come into how we simultaneously help people while saying they need to work.

In the United States right and left agreed on something called an Earned Income Tax Credit. In your tax returns you tell the government you worked and the government will top up your salary. So the Earned Income Tax Credit is a way to try to create an incentive to work because if you get a job, you’re not only going to get a wage but you’re going to get something in addition.
T N Ninan observed that he is not sure if any country actually explicitly does such trade-offs. You have one set of people who argue for one objective, you have another set of people who argue for another objective, and you may seek a middle ground, but there is no conscious trade-off. Because typically the guys who are going to be the losers are the ones who will shout the loudest and the winners are not certain that they are the winners because they don’t know what the outcome will be. So the Indian experience of doing reform by stealth or skirting the problem, meaning don’t tackle the elephant in the room head-on but try and get around it, could be a better method.

Professor Mukhopadhyay was deeply chary of business and government co-operation and consensual working. In his view business is a ‘hungry rapacious beast and it is at its best when it is allowed to be a hungry rapacious beast. The government needs to muzzle it occasionally, and rein it in, but it should not get into bed with it, because then it will get eaten up.’ So discussions between the private sector and government in South Africa need to be much more business-like. The private sector says, ‘Look we have these problems, can you fix it? And you say okay, yes or no, according to the situation.’ But no joint committees, no CEOs and ministers getting together in closed rooms to see how can we work this out because one of the things that government needs to ensure is that it is working for the private sector as a whole, not for an existing set of private firms.

Listening to the debate about South Africa Professor Mukhopadhyay was led to remark that ‘it’s as if you have got your car out of a ravine and now you are stuck getting your foot out of a ditch’.

**INDIA, BRAZIL, SOUTH AFRICA – WHAT HAVE WE LEARNED?**

The workshop concluded with a panel discussion in which panellists were asked to draw out key insights from the entire workshop.

**Professor Robert Lawrence, Professor of International Trade & Investment, Harvard University**

Where is the playing field? Who can play? How should they play? And are we all on the same team?

The first question relates to the roles of the government and state on the one hand and business on the other. All three countries have moved to a recognition that both state and business are needed for development, but two of them – Brazil and India – are also increasingly emphasising the role of the private sector.

We have heard stories of the private sector and public-private partnerships playing an increasingly important role in these societies. By contrast, this issue still seems to be contested in South Africa. We
heard a lot of discussion of the role of the developmental state, which reflects the view held by some that the state needs to do more.

The South African state was very powerful until about 1980, and my recollection is that part of the reasons for speedy privatisation was a sense that apartheid was coming under fire, and that the state should not be left with a lot of assets. So privatisation was partly about stripping the state of some of its assets rather than recognising the value of private enterprise. This may have left a scepticism about privatisation which wasn't present in the other cases.

Who can play? In all three countries, there are problems of insiders and outsiders. Big business is powerful in all three countries. Labour is formally included in domestic policy discussions in Brazil and South Africa through corporatist institutions, but not in India, where despite the many labour regulations it doesn't sound as if its unions are really powerful today. By contrast, in both South Africa and Brazil you don't get very far without big business and big labour.

A second area of contestation in respect of who is allowed to play is between formality and informality. In South Africa, the desire is to formalise everyone; no effort seems to be made to legitimise the informal sector. By contrast, we were given some incredible numbers about the strength of the informal sector in India, and its integration into manufacturing. We were also told about overlapping linkages, which create complementarities between the formal and informal sectors. So no one in that country is going to say, we have to eliminate the informal sector, and this doesn't seem realistic. In Brazil as well we heard about the evolution of a dynamic new lower middle class emerging from the informal sector. So again there is a major contrast between those countries.

As regards the rules of the game, how do we achieve reforms in each of these countries? In all three cases a domestic macroeconomic crisis precipitated policy reforms: Brazil over the course of the 1990s; India in 1991; South Africa in 1996. In Brazil's case chosen reforms were pursued systematically and have largely been sustained although more reform is necessary; in India's case they were also pursued systematically but have been pursued at the margins or 'by stealth' with not much happening over the past few years since then albeit the direction remains in place; and in South Africa's case there has been a stalling but so far no major reversal of policy reforms, even though the domestic unemployment crisis is the most serious of the three countries by some margin.

**Bobby Godsell, Chairman, Business Leadership South Africa**

I want to highlight five learnings from what has been a very rich day. The first is about government. I prefer to talk about government instead of the state. States are abstract, complex concepts; governments are more concrete. It's also not very helpful to think about adjectives; about whether it's a developmental, enabling, or night-watchman state. When we think about government, it's more helpful to do so concretely, and also to think about its quality instead of its size.

There are parts of government that work well, and parts that work very badly. I just want government to work, and I don't think anyone in government would disagree with this.
The second point is about the state and markets. Again, I prefer this to be about governments and markets. We have heard something really important today, which is that business and markets are not the same things at all. I'm keen for my country to have effective markets. If markets are effective, good businesses will survive, and the bad businesses will fall by the wayside. Crony capitalism hates transparent, open, and well-regulated markets, as does a crony state.

‘Tenderpreneurs’ also don’t function in open markets. So if you want to avoid becoming like Russia, or the state allocating licenses to operate in major sectors, then go for open, rules-driven markets with transparent decision-making. We have an effective Competition Commission which has revealed important patterns of collusive behaviour, which I celebrate.

The third point is about the formal and informal sectors of these economies, and dealing with them in the most appropriate ways. I was struck by the Indian example of the linkages between the formal and informal sectors of their economy, because I believe it’s absurd to talk about the informal sector as if it’s something over there. Former President Thabo Mbeki talked about a second economy as if it was over there. These sectors feed on each other; the issue is whether they do so productively or unproductively. Obviously, they can do so very productively.

I was also very taken with the example of Brazilian reform of the business environment, where they say to an aspirant entrepreneur, you want to run a business, be our guest – here’s an office, here’s a form, we're going to register you within three hours and give you an internet address. Why can’t we do that? It is reported that we have something like six million micro businesses in South Africa, and a shortage of businesses employing 300 to 500 people. So it’s the growth of small business that’s important.

A fourth learning we did not talk about much but I would like to know more about are relatively new and innovative poverty relief programmes in both India and Brazil, neither of which merely involve social grants. The one guarantees 100 days of employment, and the other, the anti-poverty programmes introduced under the Lula administration.

In South Africa we have a very extensive system of social grants. Are there other ways of addressing poverty, and can we learn from India and Brazil in this respect?

Lastly, I’m fascinated by the idea of business leaders being regarded as national icons, as mentioned in the case of India. This is certainly not the case in South Africa. In this respect we’re bedevilled by two things. The first is our race debate. Can we not get beyond this? We have a lot of unemployed people, and a lot of people in poverty. We can’t afford this kind of nonsense any longer. Moving beyond it will require an effort from both sides.

The second thing of course is that when we look for a poster boy it shouldn’t be Bernie Madoff or indeed Mr Kunene but somebody who’s made his money honestly and is using his wealth wisely.
Dr Sergio Fausto, Executive Director, Instituto Fernando Henrique Cardoso

There are numerous reasons to say the three countries are not in the same team: we have different populations, different demographics, and different GDPs. However, we are all emerging middle-income market economies operating as democracies; significant segments of our societies are still very poor; and we all have a history of inequality which remains a present and central political issue.

This creates a conundrum for any government. On the one hand you have to grow, and you are operating within a market economy, so you need the private sector to invest, and in order to do so the private sector needs predictability. On the other hand you are operating within a democracy, which partly means uncertainty, the freedom to choose between various policy courses, and, in our societies, a constant and significant pressure for redistribution. Dealing with these factors involve some trade-offs; you have to make choices in order to strike a balance between them. And these are not isolated acts of government, but choices made by society as a whole.

So it’s interesting to look at the advances made in these three countries over the past 20 years. What is remarkable about Brazil is that in the late 1980s, we would never have predicted that we would be where we are today. Everything was against us: hyperinflation, a dysfunctional political system, complete fiscal disarray, a closed economy, and a collapsing import substitution model. How could we possibly have achieved the position we are in today?

It has to do with the capacity of the Brazilian elite to make some fundamental choices, stick to those choices, and incorporate other actors in a broad coalition of elites, and the last actor to be incorporated was labour, through Lula. So this has something do to with our political and cultural DNA.

So we’ve been able to move ahead. But what is the challenge after you have gone a long way? It’s to keep going and not ossify this structure. From this angle we can draw interesting comparisons between the three countries.

For instance, it’s remarkable that the Indian government could change from the Congress Party to the more religious Hindu nationalist BJP party and retain some continuity. The same kinds of issues are at stake in South Africa, where role players need to say, we need to make some fundamental changes in the choices made during the transition from apartheid to democracy, we need to make some adjustments, and we need to negotiate these. Perhaps business and government shouldn’t get into bed, but they can take hands and they can talk. It is important to foster a culture of dialogue.

Brendan Vickers, Chief Director, Department of Trade & Industry, South Africa

I also wish to raise five issues. The first concerns the nature of economic growth. There’s no silver bullet for growth and development, and countries pursue different paths to prosperity. What we do know is that those countries with a high growth performance share certain characteristics. They have pursued macroeconomic stability, they have had investment driven hard by the public sector, and they have introduced institutional and regulatory reforms suited to local conditions, local institutions, and local investors.
So, while recognising the importance of growth per se, it is the quality and sustainability of such growth, that is more important. South Africa has essentially attracted the wrong kind of growth. While the economy grew by about 5 per cent between 2005 and 2007, this was largely driven by consumption, household debt, and financial services, with few employment multipliers. It hasn’t been inclusive or socially productive, in fact, we’ve lost productive capacity, so in the long run we may just end up digging things from the ground without adding value.

My second point is about the nature of the state, but also how government and business, or government and the market, contest power and regulation within this economy. If one looks at the socioeconomic challenges faced by all three countries, the case is there for a democratic developmental state, or a democratic developmental regime, however we want to define it; whether it means that the government drives and promotes industrial transformation and economic diversification, invests in human capabilities, or invests in service delivery.

Central to all this is the capacity of the state. The discussions have underlined that all three countries have the political legitimacy to formulate progressive policies, but we often lack the administrative, bureaucratic, and technical prowess to implement those policies. The danger lies in the orthodox fallacy that, because the state does not have sufficient capacity, the default driver for democracy and inclusive growth development must be the market, which might be the wrong choice. Rather than simply leaving everything to the market, the question should be, how do we strengthen and harness the transformative capacity of state power?

The third issue is the policy context: which policies should we adopt to operationalise the notion of a democratic developmental state? The workshop has produced some comparative lessons for the future, including the role of public-private partnerships, and how these can be leveraged for socially-productive ends.

We’ve spoken about the artificial distinction between the formal and the informal economy, and their integration into a single growth dynamic. We’ve heard that the formal economy has been a source of job creation in Brazil and the informal economy a source of job creation in India, so we need to understand those dynamics, especially in the South African context.

The fourth issue is the institutionalisation of state and government capacity. Again, we can learn a great deal from these three countries about the kinds of institutions and institutional architecture that underpin growth, policy planning, and policy co-ordination – and also about performance monitoring and evaluation. How do you monitor and evaluate a government’s performance? These are among the issues that lie at the heart of the developmental state.
In South Africa, for instance, we have a proliferation of institutions under the current administration. There is contestation over macro and micro-economic policy, and we have a National Planning Commission which has little executive authority, but acts as a think tank within government. So we could learn from the Indian Planning Commission, for instance, about how you co-ordinate across government in terms of policy and budgetary processes.

Finally, we haven’t spoken about the importance of regional policies. All three countries are dominant economies in their respective regions. How do you leverage regional integration to support growth and development back home? South Africa has a clear incentive to deepen regional integration because this can be used to support our industrial diversification objectives and job creation objectives at home. Since our trade with African countries is not in commodities but in value-added manufactured products, more integrated regional markets can support our industrial development and employment creation objectives, as outlined in the New Growth Path and the Industrial Policy Action Plan (IPAP-2). So this is another dimension we need to think about in the future.

Dr Pratap Bhanu Mehta, President and Chief Executive, Centre for Policy Research

In India when we held debates of this kind there was always somebody banging the table and saying, we need to come down to earth, we need a little less poetry and a little more plumbing. But I’m struck by how much poetry you do need for reform, not only in an ideological sense of a very clear vision. Both India and Brazil have elites that have historically regarded themselves as playing a hugely significant role in world affairs. It helps to have elites that are full of themselves; a sense that there is a big world out there to be conquered transforms that aspirational story quite significantly, and creates the basis for surmounting some smaller differences.

This has certainly been part of the reform story in India; even in the 1950s, an elite tried very self consciously to remake the world order in a certain way, perhaps punching above its weight. The same is probably true of Brazil. Therefore, it is hugely important to have elites which place their aspirations in a global context, as opposed to elites which are on the defensive. And this aspirational story gradually trickles down to their societies.

My second point is the bad news about democracy. The reason why elites fell in love with democracy in the 19th century is that they found that democracies did not threaten anyone. People used to think that, if you gave people the vote, the poor would vote out the rich at some stage, and property would be expropriated. However, democracies are very conservative when it comes to dealing with historical inequalities. For example, Adam Smith said democracy would be last to abolish slavery. This is an uncomfortable fact about democracy we have to face up to. There are no structural inequalities which democracies have not been able to mitigate over 10 to 15 years. Therefore, a lot of what elites have to do in democracies is to intelligently manage the sense of expectation and social contradiction, often by divide and rule, often by creating forms of political mobilisation that mitigate structural polarisation. All three of our democracies are wrestling with these issues in some ways.
There seems to be a consensus around some basic propositions of how to run economies. You need a degree of macroeconomic stability; obviously hyper-inflation is a bad thing. But once you move beyond that realm it’s amazing how many of our judgments about what worked and did not work are actually retrospective, which raises this interesting question of what the forms of knowledge are that elites have to internalise in order to play this game of economic reform.

At one level it’s very reassuring that part of the world is run by politicians rather than economists, because the one skill politicians have is to instinctively grab at opportunities. There is no textbook template for reform. It’s really about whether 95 per cent of the country thinks this is the right policy, but there is a very powerful group in a relatively small or marginal constituency that can obstruct this reform for five years or even 10 years.

This underlines the role of political creativity in terms of sequencing and managing reform. The trade-offs mentioned by Robert Lawrence are correct, but timing is all-important in a democracy. It’s amazing how in six months a window of opportunity can be lost. How do politicians actually manage these conjunctures and are democracies necessarily better at it? One of the arguments we made about the Chinese regime is that it has displayed some of those subtle traits in interesting ways.

The last point is the issue of state capacity. At one level, in relation to the challenges they face, our states have serious incapacities, and, on any measure, can’t deliver all the things they are supposed to. But we need to distinguish between raw bureaucratic capacity and political capacity, namely the ability of states to effectively engineer trade-offs between different constituencies to allow the system to function.

Being politically creative in that way may create another level of state incapacity; put differently, it’s an open question whether or not the most efficiently-run bureaucracy is compatible with this kind of political creativity. So a willingness to live with a certain degree of messiness and ride it rather than to try and smother it seems to be one feature common to all.

**KEY INSIGHTS**

*Ann Bernstein, Executive Director of the Centre for Development and Enterprise, initiator of the think tank consortium and chairman of the workshop proceedings, pulls together some key insights from the day’s discussion.*

The establishment of a think tank consortium across three countries and continents is a bold initiative and the aim of learning from three vitally important countries – India, Brazil, and South Africa – is
DEMOCRACY AND INCLUSIVE GROWTH

an ambitious endeavour. The consortium will structure its work under the broad umbrella theme of democracy and inclusive growth. We intend to learn more about each other’s countries and look for comparative insights. This new knowledge will be used to further and strengthen each think tank’s activities promoting domestic reforms in their own country; and it will be used – in time – to influence the global conversation about development strategies, priorities and achievements.

This first workshop demonstrated the vital importance of getting beyond the slogans, the PR images of countries, and into the particularities of what is actually happening. These are three very different societies on three complex and diverse continents. All are democracies wrestling with the challenges of driving economic growth, dealing with mass poverty, the politics of inequality and the dynamics of rapid social change.

The dominance of Western countries, their media, intellectuals, and experts in shaping global conversations about development and growth is striking to those who live outside traditional global centres of power and influence. Western-influenced agendas are often out of touch with the realities of developing countries. It was striking that at no point was the question of foreign aid mentioned in this intense workshop covering so many of the vital issues affecting growth and development. This would be rare in a Western conversation about these issues where it is often forgotten that for middle-income developing countries foreign aid is a very minor factor affecting the future of these societies.

In the context of the phenomenal achievements of China over the past three decades and its growing power and influence across the globe it is important to appreciate the changing environment within which debates about growth and development now take place. Many political leaders in the developing world as well as many other experts and interests, now associate efficiency and capability – development success essentially – with an autocratic, authoritarian political system. And yet there are many democracies in the developing world, notching up real achievements, making progress and wrestling with the complexities of growth in very different circumstances. If you are a democrat, these are very important and interesting societies.

What has been called ‘the rise of the rest’, i.e. the developing world, will have political and other consequences. There are new ideas, new approaches to development, and new experts emerging in India, Brazil, South Africa and elsewhere.

In this final section, we try and pull out some of the challenging and interesting ideas and insights arising from this first workshop.

States and markets

This is a topic that encourages a great deal of rhetoric and ideological positioning. It’s important to dig deeper and think harder about the realities behind the bombast. The advocates of the so-called ‘Washington Consensus’ for developing countries, themselves often lived in developed countries with very large states. Even before the 2008 economic crisis, many Western countries had states that devoured nearly half of GDP.
That said, all three countries encompassed by this initiative have very large state sectors. In India the state sector remains dominant, at over 50 per cent of GDP. In Brazil, under military rule in the 1960s to 1980s, state-owned enterprises multiplied, especially in the areas of infrastructure and basic inputs into the industrial process, and although significant areas of the economy have been privatised, large sectors are still in state hands. In South Africa, modest attempts at privatisation ground to a halt in about 2004, and many key economic sectors (including electricity, rail, road, air transport, and ports) remain state-dominated.

We need to debunk false dichotomies between the market and the state. In each country there is an interesting, controversial, and more-or-less successful search for state models that can facilitate a market-friendly environment and economic development.

How the state manages globalisation in relation to market forces differs in each country and is expressed in different institutional arrangements. The debate within each country about these issues and the national interest is ongoing. Some examples are illustrative. Is it important for countries to prevent foreign ownership of their banks (India)? How do you protect national manufacturing capacity in a global economy – in whose interests and at whose expense (Brazil and South Africa)? Should there be state champions, state banks, state mining or oil companies and so on (Brazil, South Africa, India)?

Effective market economies require smart states. Governments that ensure excellent infrastructure can greatly boost market dynamism; governments that ensure quality education for all their citizens reap massive returns. However, this requires state officials who are competent, able to manage large systems and complex projects, and able to regulate sophisticated companies. It also requires politicians and state officials who want markets to work and can accurately gauge the complex relationship between effective state performance and market-friendly intervention. This is the ideal – in too many instances the three countries under review are experiencing areas of great incompetence and inefficiencies in their state sectors coupled with politicians and officials that want a more activist state that hampers rather than facilitates the development of markets. Reforming large public sectors in these societies is a huge and common challenge.

**Business and government**

Frequently people speak much too loosely about markets, states, business, and government. These are not interchangeable terms and should not be used as such. In formulating this workshop we are guilty of this charge and it is an important warning that comparative research requires clear, common definitions of terms to ensure comparability and clarity in exactly what is being discussed.

Nonetheless, this theme raised many important questions. Who are we talking about when we refer to ‘business’ – large companies, organised business associations, tycoons, small enterprises, urban or rural
companies, ethnic or caste based enterprises or business associations? The role of the business sector in economic reform is another vital issue worthy of more attention. This is clearly very different in each of the three countries, in part as a result of their particular histories. However in all three countries, large companies have had to move away from behind the scenes one-off or special deals that characterise non-democratic situations or highly state-oriented systems, to participating in the public debate about general rules to govern economic activity and corporate opportunity. There are therefore increasing areas of common interest and comparability across the three countries concerning how companies participate in the democratic public square.

In this respect a key challenge in all three societies has emerged. Does liberalisation of the economy lead necessarily to state capture by very powerful business interests? And if so, what can be done to counter or contain the situation? This important dimension of corruption – also a common challenge – can be seen in a number of forms: the growth of oligarchs, well connected to government officials and cabinet ministers; South Africa’s ‘tenderpreneurs’ who get state contracts without qualifications or competitive pricing solely as a result of relationships with politicians and officials; the businesses that buy politicians thus infiltrating key democratic institutions. How should this corrosive dynamic be combated?

Democracies with a free press and feisty civil society organisations have an advantage in this arena. Laws can encourage as much transparency as possible, watchdogs can be established – independent of the state as well as parliamentary committees – and the free media can discover and report on corruption. These processes could encourage remedial action by the state or allow voters to know what is happening so they can ‘throw the rascals out’ in the next election. However it is most likely that enforcing vigorous and intense competition between companies within the economy (and political parties in the electorate) will be one of the most powerful tools preventing business from capturing elements of the state. Similarly multi-party political systems that result in regular peaceful transfers of power between one political group to another will also help to curb corruption. Public education about the value of competitive processes would also make a difference.

**Economic growth changes attitudes**

The impact of economic growth in a society can be profound. Some striking examples illustrate the enormous dimensions of this.

In Brazil as the economy started to grow and people saw new opportunities opening up for them in the private sector so their expectations of the state changed. They now wanted the public sector to focus on basic public goods (water, roads, infrastructure) and they sought jobs, opportunity, and increased security from the private economy. For example as the emerging middle class expanded, newly-empowered people started to look to the well-organised private sector health insurance system.

In a different context the growth of successful global Indian multinationals has changed the way in which other countries and companies view not just those Indian companies but the country itself. India is seen as a much more attractive place in which to do business than before. Within India, leading edge companies have become ‘national icons’ – an unexpected and remarkable phenomenon considering
India’s past. The corporate leader as national hero is a different angle on traditional approaches to development strategy and national mythology.

Many South African companies have expanded successfully into Africa and some have emerged as leading global players. Many of these companies have seen themselves as ‘ambassadors’ for the country and even the whole continent, spearheading a new era of African growth and potential.

The challenge of sustaining reforms

The 2008 global Commission on Growth and Development report, which looked at 13 developing countries that had sustained high rates of economic growth over 25 years, illustrated the exceptional success stories of the modern era. According to the report, one set of challenges needs to be overcome in order to embark on an economic reform strategy. Quite a different set of issues come to the fore when you need to ensure that reform momentum is maintained and deepened.

In all three of the countries examined in our workshop, market oriented reforms have taken place over the past 20 years. And yet so much more needs to be done. All three have introduced sensible macro-economic management – that aspect of the ‘Washington Consensus’ stands firm. However in all three countries the absolutely vital accompanying micro reforms that complement and give meaning to this macro consensus have not been followed through or taken far enough.

The challenges that remain are clearly visible. India, Brazil, and South Africa face an enormous threat to their competitiveness as arenas for economic growth. In comparison to China for example it is quite clear that – in different ways – each country lags with respect to the quality of its infrastructure (think of Brazilian airports, South African ports, Indian roads); the quality of its schooling for the vast majority of its citizens (although Brazil is now seen as one of the fastest improving systems from a low base); and both Brazil (less so) and South Africa lag badly with respect to higher economic growth rates so essential to drive inclusive growth and sustain democracy in these societies.

Two interesting points emerged from the discussion. The first concerns the role of political leadership and the role of elites more generally in promoting reform. It was pointed out that the genius of politicians – as opposed say to economists – is that their expertise lies in ‘seizing the moment’; opportunistically turning a crisis into an opportunity and moving situations in a new direction. Effective politicians and other policy players are good at the old adage: never waste a good crisis! They have reform proposals ready for when situations allow new ideas to emerge and transcend the obstructive or vested interests so that the unpopular can become a new unavoidable and necessary priority.

The second point concerns the importance of politics and building a coalition of interests around the reform process so as to maintain the necessary momentum. Some Indian states are doing this better than the federal government, and Brazil seems to have built sufficient momentum for reform across...
party lines going into the third reform presidency of Dilma Rousseff. The reform process in South Africa seems stalled for now as internal debates within the ruling alliance take centre stage at the expense of effective leadership of the country.

**Inclusive growth**

This fashionable new phrase is used by the governments of India, Brazil, and South Africa but seldom defined. Three issues are worth raising briefly.

In all three countries social mobility is a reality. It is also a political factor whose dynamics and potential are not yet fully understood. Nonetheless it is instructive and hopeful that Brazil has recently had a president who rose from the dirt-poor North East of the country to the very top of the society. And his vice-president came from a similarly disadvantaged background. The American dream playing out in Latin America! South Africa’s president and many of its cabinet come from poor families. The Indian Prime Minister is the exception, arising from that country’s phenomenally well-educated elite, but the heads of many regional states come from the most deprived groups in India including the so-called ‘Untouchables’.

In India ‘inclusion’ has been seen in a number of ways. The Indian constitution of 1950 outlawed social exclusion through the caste system and this has been coupled with aggressive affirmative action. Economic inclusion has included:

- Traditional redistribution including land reform that has not gone very far;
- The development of a safety net which comprises the national rural employment guarantee scheme, a subsidy for food grains, and a public sector distribution system.
- Together these two schemes absorb some $20 billion per annum.

The more interesting and sustainable aspects of inclusion in India involve growth and private activity. As the economy has grown at fast rates so the question of who is a part of this growth emerges. Do individuals, and if so which ones, feel they are a part of the growth story? A remarkable aspect of inclusion in India has been demand-led. The phenomenal expansion of private schooling across a range of income categories from the poorest upwards, is one very powerful example. Parents vote with their feet to ensure their children access English-language education because they know this is absolutely vital for economic success.

The Brazilian approach to welfare has been innovative. The formal economy is based on a minimum wage and pensions schemes linked to inflation. With respect to the mainly rural poor, the state has pioneered the BolsaFamilia programme providing very small amounts of money for a well-targeted population on condition that children attend school and receive regular vaccinations against preventable diseases. However, there is debate as to the respective roles of minimum wages and BolsaFamilia in the spectacular growth of a new lower middle class of some 30 million people in the country. There is also concern as to whether the formal system is affordable and therefore sustainable.
South Africa has built up what is probably the most extensive and expensive welfare state in the developing world. This now encompasses some 15 million people and involves a variety of unconditional grants: for child support, for housing, land, free basic services, as well as old-age pensions. The country’s previous finance minister himself raised questions as to its sustainability and affordability. Interestingly the country is also now developing a large and growing sector of private schooling for the poor.

It is very important not to confuse the issues of poverty and inequality. To avoid the confusion, it helps to put the second issue in the plural – inequalities. Some inequalities are morally unacceptable, others are not. It is unacceptable if children in an affluent neighbourhood have a problem of obesity, while children across town are dying of malnutrition. This is an inequality which calls out for policies of intervention. Very likely there are also inequalities between children in the affluent neighbourhood. One child is driven to school by a uniformed driver in a Mercedes; another child is taken along in the father’s slightly beat-up Toyota on his way to work. That is an inequality that does not call for moral outrage or state intervention.

If one is concerned about the very real sufferings of poverty, one should not be too distracted by the issue of inequality. Redistributionist policies to reduce inequality have a very mixed record. Nonetheless, in at least one respect, inequality is a crucial issue in all three societies: inequalities of opportunities.

The record on the link between poverty and economic growth is less clear. Empirical evidence shows there can be less and more pro-poor growth. Furthermore, poverty can be reduced to a greater extent under lower rates of growth, depending on the public policies adopted. Brazil experienced lower growth rates in the last 15 years than under the military regime. At the same time, poverty was reduced more rapidly. Nonetheless, policies favouring economic growth should be the principal focus if one is concerned with poverty. Saying this is not to imply that there should be no other policies to attack poverty. The record indicates that policies on health and education are particularly effective. And there is new evidence in all three countries of the success (and sometimes the failure) of additional approaches aimed at providing mechanisms to help poorer people get into the modern economy and its wealth of opportunities.

The puzzle of jobs and rigid labour legislation

All three countries have rigid and restrictive labour legislation. The pressures for reform of this system differ in each situation. Three important issues emerged from the discussions.

In India it is remarkable that over the past 10 years of 7-9 per cent growth per annum, there has been no relative increase in the proportion of formal sector jobs to informal sector jobs. In other words the informal, unregulated sector appears to be intertwined with the formal economy in unusual ways. In Brazil the rigidity of the labour market is a key factor in making most manufacturing globally
uncompetitive and there too the informal unregulated sector of the economy is very large. Nonetheless they have managed to grow formal-sector jobs. South Africa’s official statistics indicate a surprisingly small informal sector with insufficient clarity on why this is the case – whether this is a question of definition, a legacy of apartheid, or some other explanation is not yet resolved. The three think tanks will work on this area in the future.

In all three countries it appears as if there are two large agendas often working simultaneously. The first is a set of attitudes and associated reforms favouring deregulation; the second is a set of pressures, vested interests and legislation that are consciously and sometimes inadvertently opposed to markets and greater market access. In South Africa this is visible in the latest official amendments to labour legislation which are currently being hotly debated, and proposed environmental legislation and mining regulations. The ruling party has appointed a commission to look into nationalisation of the mines.

In Brazil, a diffuse statist mentality still prevails among key sectors of society, including the average voter and the average politician. With regard to the former, things are changing, in the wake of the emergence of a new middle class which sees its upward mobility as more dependent on access to markets (credit, education, etc.) than on state assistance. Politicians are lagging behind this process since they still operate as intermediaries in clientelistic chains of representation, having dependent clients on the one end and public funds on the other. The electoral system favours the perpetuation of clientelistic relations. Big business has a two-pronged strategy: on the one hand, they praise transparency and rule-based decision-making and largely behave like public corporations; on the other, they take good care of their special relations with the state bureaucracy, dominant parties, and the pension funds of state-owned firms. Labour unions and social movements are co-opted by the state. Further advances towards more rule-based and transparent relations between state and business, and state and citizens depend on the re-ignition of the spirit that presided over the reforms of the 1990s. In the last 10 years or so, the reformist trend has receded. The regulatory framework implemented after privatisation has been deliberately weakened. At the same time, policies targeted to build and strengthen alliances between state-owned enterprises and hand-picked ‘national champions’ have become more the rule than the exception.

Urbanisation, land reform, and the demographic dividend

One of the clearest correlations in social science occurs between higher economic growth and increased urbanisation. It is significant that Brazil is now over 80 per cent urbanised, and is simultaneously seeing a dramatic growth in ‘the new middle class’ and a reduction in poverty. By contrast, both India and South Africa display a deep ambivalence about urbanisation. Both countries have very different but nonetheless romantic notions about rural life and its relationship to national identity. Although South Africa is now about 60 per cent urbanised, its latest official economic growth plan does not mention an urban strategy, or how best to deal with urbanisation. While India is the least urbanised of the three countries, with 29 per cent of Indians urbanised in 2008, aspects of its welfare strategy involve implicit attempts to ‘keep’ people on the land and out of the cities.
India and South Africa are still young countries. Nandan Nilekani, former CEO of one of the iconic Indian IT companies, Infosys, has written eloquently about the demographic dividend that could be reaped in India if millions of young people were given a decent education and economic opportunities. This is also possible in South Africa, but this potential is being undermined and squandered by the massive unemployment rate among young people, the poor education available to most of them, and a health crisis involving AIDS and tuberculosis, which mainly affects younger South Africans. In both countries, bold policy reform could lead to enormous progress.

Brazilian society, on the other hand, is starting to age, which will present policy-makers with a different set of challenges in time.

In all three countries, issues of land reform are important and partially unresolved. Brazil seems to have made most progress with dramatic developments in its agricultural sector so that it is now one of the world’s largest suppliers of coffee, soybeans, beef, sugar cane, ethanol, and frozen chickens. Nonetheless, there are still major challenges around land, mainly in the rural sector, where after 15 years of intense land reform less than 10 per cent of total assentamentos rurais (rural settlements of ex-landless people) are sustainable without permanent public funding. In South Africa – a largely arid country – agriculture is a relatively small and declining part of the economy. In part this decline is a result of the negative consequences of a badly-managed land reform process. India is slowly experimenting with the introduction of modern supermarkets which will introduce efficient storage, transportation, and distribution of agricultural goods, thus moving away from a situation in which some 30 per cent of farm goods are wasted or destroyed before getting to market. It is hard to see how the modernisation of the rural economy in India and South Africa (and probably parts of the Brazilian northeast) can take place without grappling with the issues central to land reform: dealing with historical issues about inequity and access; and finding the best possible route to modernisation with respect to traditional land holdings.

**New models of development**

One part of moving beyond a unipolar world is that there are now a number of competing ideas and models across the globe with respect to governance, development, and financial regulation. Global competition will increasingly include debates about different forms of development.

In this context it is important for experts from developing countries to participate fully in describing, defining, and communicating the new approaches being tried out in their countries. If they do not, experts based outside those countries and located in the traditional global centres of communication, power, and influence will be the ones to decide how these new models or approaches should best be defined. An example here is BolsaFamilia, the now famous Brazilian programme of assistance to...
poor families. There is considerable debate inside Brazil about the exact impact of this programme. Outsiders often link its success to the massive growth of the new middle class. To that end, however, more important than conditional cash transfer programmes have been the dynamics of labour and credit markets, as well as greater access to education. How applicable this programme would be in other developing countries is not self-evident. South Africa, for example, does not need to subsidise families in order to encourage school attendance; some 97 per cent of children are already in school. The quality of schooling they receive is a much bigger challenge.

What is required now is much more focused and intensive research into the realities of developing countries. Our growing knowledge of just three – India, Brazil, and South Africa – has revealed the complexity of each country, the facts and trends behind the PR images and media soundbites, and the common issues that can be talked about in comparative perspective. Such perspectives are only really useful if based on a real familiarity with and understanding of each society.

Is a new development approach discernible in these three democratic, middle-income developing countries? This is not yet clear. What is happening is certainly different from much of the rhetoric or prescriptions about development of the past 50 years.

Each country is uneven in its stage of development, and one needs to understand more about each major sector – from growth strategy to welfare, education, health, and agriculture. And we need more honesty about comparisons with industrialised countries, which often say one thing about what developing countries should do and practise something else themselves.

What we are seeing in all three countries is a common desire for market-driven development (more or less), coupled with a historically large state, and a preference for the state to play a major role in strategies for growth as well as the inclusion of more and more people in the modern economy and society. To what extent this is what we have traditionally described as a mixed economy, or the development of new form and content in the developing world, remains to be seen.

At the same time, some of the interesting new developments do not always include the state. Thus ‘private coping’, such as the growth of private schooling for poorer people in India (where it is massive) and South Africa (15 per cent and growing), is one example of how market dynamics are responding to demand. A second area is the impact of employment. Contrary to the many well-meaning and often state-driven or foreign-funded ideas of how to help the poor, it is clear that employment is often the best way out of poverty and into a world of skills and new opportunities, albeit – initially – at a very low level. The 90 million people moved out of poverty in India over the past 20 years provide a striking illustration that faster economic growth and more market opportunities offers the most sustainable and empowering route out of poverty.
'Poetry and plumbing'

One of the important insights arising from our discussion concerned leadership and vision.

How political and economic elites in a society think about its future is of fundamental importance. If leaders are ‘export pessimists’ they want to protect local companies and put up barriers to foreign competition. However if they believe that their country, companies and citizens can compete with the world’s best, then a more open society can emerge. And it has been proven again and again that a wealthier, more innovative society follows from that as well.

Development of a nation is about so much more than only economic policy and yet too often it is reduced to that. A country’s future is determined by leaders’ attitudes to the outside world and the policies and strategies that flow from this perspective. It is also determined by the vision leaders offer their citizens. A Chilean politician, Felipe Kast, talked recently of changing ‘the inequality of dreams’ in his society. A profound insight. If poorer people or formerly excluded groups feel they are now part of the modernisation story, their attitudes change, they dream bigger for themselves and their children, and in so doing can drive their society to greater heights. The skill of leadership is to make sure that people are encouraged to think big and that the new opportunities (in education, employment, health and urbanisation) are available and working to best effect for as many people as possible.

Development policy inevitably involves a lot of ‘plumbing’ – sober, often highly-technical implementation, and tinkering with the physical and institutional conditions under which people live. This is essential if you want clean water, roads and electricity. However political leaders who are nothing but ‘plumbers’ are unlikely to inspire the efforts, and often the sacrifices, that are necessary for development. ‘Poetry’, the vehicle of dreams, is also called for.

At the battle of Agincourt, celebrated in a famous play by Shakespeare, Henry V of England defeated the French in 1415. According to one source, just before the battle a man on horseback was gripped by wild enthusiasm. He rode up and down in front of the massed English troops and shouted at the top of his voice ‘God for England and St. George!’ British historian Gilbert Keith Chesterton, in an essay attacking historians who only look at rational interests, said that one cannot understand what happened at Agincourt if one ignores the man on the horse. Sometimes men make valiant efforts for poetry; they rarely do so for plumbing.

Democracy and development

The relationship between democracy and development will be a major topic in the century ahead. Its capacity to foster more inclusive development is certainly not the only reason for favouring democracy. At least under modern conditions, democracy is most likely to bring about decent government – that
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is, government that respects basic human rights, and is concerned with the wellbeing of its subjects. Democracy might be favoured even if it did not bring about development, and one might oppose authoritarianism for its brutalities even if it did. One may not fully agree with the argument, forcefully made by Morton Halperin et al in their book The Democratic Advantage, that democracy is indeed an advantage for the promotion of prosperity. But it is no mean contribution to the global debate to say that democracy need not be a disadvantage. Put more positively, really inclusive growth is only possible under democracy, unless one sustains a very narrow concept of inclusion.

The three countries involved in the INCLUDE consortium are prime cases to test this contention. All three are robust democracies. India has been a democracy since independence, with the brief interruption of Indira Gandhi’s emergency rule. Brazil had a long democratic tradition to which it returned after the demise of the military dictatorship. South Africa created a non-racial democracy after the negotiated demise of its apartheid regime. Is there a guarantee that the three countries will remain democracies forever? Of course not. (It is not difficult to imagine circumstances under which even Switzerland might come under authoritarian rule.) But at present there are no indications of an end to democracy in any of the three countries. India and Brazil have had democratic alternations of political power, with an opposition party succeeding an incumbent group. Although South Africa has not yet passed this test, the fact that four very successful national and four separate local elections have been held is a good omen, although not a guarantee.

Their record in terms of inclusive growth is uneven. Both India particularly, and to a lesser extent Brazil, have grown more rapidly than the South African economy. (The relatively recent end of apartheid and a number of anti-growth policies may help explain this discrepancy.) In part because of this discrepancy, the reduction of poverty in the first two countries has been much more spectacular, although in Brazil conscious social policies have evidently played an important role too. In recent years tens of millions of people have moved out of extreme poverty in India and Brazil. Social mobility in South Africa has been more modest; nonetheless, large numbers of poor people have experienced greatly improved access to basic services such as running water, electricity, and health care. The indicators of inclusion point upward.

The stories of the three countries already provide an argument for the compatibility of democracy and inclusive growth. It is our hope that the argument will develop into an empirically solid model of inclusive growth under democratic governance.