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Reexamining Role of the State in Promoting Development*

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Summary

The main topic of investigation in the article is role of the state in promoting development. This article argues that, during the 19th century and at the beginning of 20th century, liberalism had a positive impact on economic growth because liberal economy reduced predatory role of the state in the economy. However, the Great Depression showed limits of classical liberal capitalism. Therefore, the concept of developmental state replaced liberal economy. Empirical investigation shows that, during the last fifty years, almost all the countries that had fast growth of GDP per capita had very strong role of the state in promoting development. Nevertheless, at the beginning of 1980s, neoliberal concept prevailed once again. As a consequence, reduction of state interventionism has had a negative impact on development around the world. Hence, it is important to reexamine role of the state. After investigating role of the state from historical, empirical and theoretical prospective, this article concludes that a prudent and comprehensive state interventionism produces better developmental results than (neo)classical model of capitalism.

Key words: development, economy, economic growth, interventionism, neoliberal concept, the state

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For impoverished masses it is surely untrue that that government is best that governs least.

Karl Deutsch

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This article investigates the theoretical debate and the historical experience concerning the role of the state in promoting development. The main hypothesis is that, in modern time, almost all the countries that were the most successful in promoting development had very strong role of the state in the economy.

Until Adam Smith published *The Wealth of Nations* (1776) it was assumed that the state had the most important role in economic prosperity of a country. Smith's book was really a revolution in social science, because this book revealed the power of the "invisible hand" of the market. Smith's book was not only a panegyric to the market but also a strong criticism of the role of the state in the economy. "The uniform, constant, and uninterrupted effort of every man to better his condition, the principle from which public and national as well as private opulence is originally derived has been powerful enough to maintain the natural progress of things toward improvement, in spite both of the extravagance of governments and of the greatest errors of administration" (Smith, 1930: 325).

For Smith, government is the problem and the market is the solution to the problem. Smith had many reasons for this claim. From the 15th century until the end of the 18th century GDP per capita growth was, on average, only .04 percent annually (Maddison, 1995: 20). Though the state conducted certain activities for the well-being of the entire population (protection from foreign invasion, for example) and although the mercantilist state might have had certain positive influence on the economy, there is no doubt that, during this period, the state had mainly a predatory function. Precise measurements of income inequality are not available until very recent time. However, it is enough to compare the luxury of the palaces in which nobility used to live with the living conditions of the poor people – a great majority of the population – to conclude that up until the 19th century the state was used almost exclusively for exploitation. Therefore, a liberal idea that demanded a limited role of the state in the economy had a positive influence on economic growth.

It is probably not a coincidence that Smith's book was published in the same year (1776) when the American Congress declared independence, and it is sure that the Founding Fathers were influenced by Smith's work. Jefferson's motto – that government is best which governs least – is a paraphrase of Smith's thoughts. The first modern democracy, the USA, combined democracy with liberalism. This combination has proven to be very successful in promoting development. During the 1830-70 period, the United States (the only democratic country in the world until 1868) had an average rate of GDP per capita growth of 1.3 percent per year.[1] In this period, the average rate of growth for entire world was less than .6 percent per year (Maddison, 1995: 60). During the 1830-1929 period other democracies, which also combined democracy with laissez-faire capitalism, were much more successful than dictatorships in promoting economic growth. During this period of time, they had GDP per capita growth of approximately 2 percent per year. In contrast, dictatorships posted less than 1.3 percent annual GDP per capita growth from 1870-1913 and less than .9 percent annual growth during the 1913-50 period.

Liberalism, meaning limiting the role of the state in the economy, decreased predatory capabilities of the state. In addition, the introduction of democracy also decreased the predatory function of the state because politicians had to pay attention to voter opinions. Therefore, the period from 1776-1929 was a triumph of the liberal idea that

[1] All the data about GDP per capita growth prior to 1951 are from Maddison (1995). Classification of regimes is taken from Przeworski et al. (2000; 104-5).

direct state intervention in the economy has a harmful effect. Economic success of liberal countries confirmed the main postulates of liberalism. At the beginning of the 20^{th} century it seemed obvious that the market is good and state interventionism in the economy is bad. Furthermore, the period from 1815 till 1914 was one of the most peaceful periods in human history. It was assumed that liberalism, bolstering international trade, promoted peace and this, in turn, upheld economic growth.[2]

World War I and the October Revolution were the first signs that liberal order is far from perfect. There are many factors that caused WWI. However, there is no doubt that competition among capitalist countries for colonies was one of the factors, if not the most important factor, that caused this war. World War I was proof that liberalism does not guarantee peace and economic growth. Furthermore, huge social differences in all the countries in the world, which were not decreased with the introduction of liberal capitalism, helped to bring on communism in Russia. Moreover, the Great Depression (1929-32) challenged the idea that the market alone, without state intervention, could solve economic problems. During the same period of time when the West was in a deep economic depression, the Soviet economy – which was completely under the control of the state – started a rapid industrialization, and from 1928-41 the Soviet economy had faster economic growth than capitalist economies.

Liberal democracies did not use all of the potential of the state in promoting economic growth. There are two main reasons for this. First, state interventionism goes against liberal ideology. Second, state interventionism always demands a certain level of redistribution of wealth and this is exactly what the governing elite in liberal democracies wanted to prevent.[3] Therefore, they did not optimize resources. In addition, liberal democracies bred huge social differences. Laissez-faire democracies decreased the predatory functions of the state but they did not use the state as a tool for reducing inequality. In contrast, the communist regimes used the state for promoting economic growth and for decreasing social differences. When the communists took power they nationalized national resources. These resources – which were used very inefficiently during the period of czarism – were invested in industrialization, education, infrastructure, health care etc. Furthermore, nationalization decreased social differences that were enormous during czarism. Rapid economic growth was a consequence of these measures.

The changes occurred not only in the Soviet Union but also in the West. Fascist corporatism in Italy, state capitalism in Germany, New Deal in the USA all had one thing in common – a state regulated economic process. These political and economic processes were echoed in economic theory. In *The General Theory of Employment, Interest and Money* (1936), Keynes argued that the government should regulate business cycles. On the basis of Keynes' economic theory, the USA not only solved the economic crisis but also, in 1945, started to be the strongest economic and military power in the world. In that year, the USA produced approximately 50 percent of GDP of the entire world and was the only nuclear power in the world. According to the World Bank

[2] About the relationship between liberalism and peace see Kant, 1796; Owen, 1994; Layne, 1994; Copeland, 1996 etc.

[3] It was already stated above that state intervention, in a predatory state, might further increase social inequalities. For analysis of state intervention that increased social inequality in Africa see, for example, Bates, 1981. The paragraph above wants to stress that liberal democracies tend to prevent the usage of state apparatus for the promotion of social *equality*.

"the Great Depression was seen as a failure of capitalism and markets, while state intervention (...) seemed to record one success after another" (1997: 23).

However, critics of the welfare state, which was the consequence of Keynesianism, came from the leftist and from the rightist perspective. For communists, the welfare state is only another type of exploitation of the proletariat. Since during the Cold War the USSR was on equal footing with the USA in military might, having at the same time faster growth of GDP than the USA, the Soviet model was attractive for new independent states. Most developing countries in Asia, the Middle East, and Africa came out of the colonial period with a strong belief in state-dominated economic development. The state would mobilize resources and people and direct them toward rapid growth and the eradication of social injustice. State control of the economy, following the example of the Soviet Union, was central to this strategy (The World Bank, 1997: 23).

In contrast, for rightist economists who follow the principles of classical liberalism, the welfare state means too much state. According to Hayek, "that hodgepodge of ill-assembled and often inconsistent ideals which under the name of the Welfare State has largely replaced socialism as the goal of reformers needs very careful sorting-out if its results are not to be very similar to those of full-fledged socialism" (1994: xxxiv, 6). And, for Hayek, socialism is the road to serfdom. "Few are ready to recognize that the rise of fascism and nazism was not a reaction against the socialist trends of the preceding period but a necessary outcome of these tendencies."

Milton Friedman goes a step further. According to him, almost all the activities of the welfare state can be much more efficiently performed through private initiatives. For Friedman, social security, public assistance, housing subsides, Medicare, Medicaid, even public schools are a waste of money. Friedman's opinion about public health care shows the essence of his theory: "Two major arguments are offered for introducing socialized medicine in the United States: first, that medical costs are beyond the means of most Americans; second, that socialization will somehow reduce cost. *The second can be dismissed out of hand – at least until someone can find some example of an activity that is conducted more economically by government than by private enterprise*" (italics – M. A.) (Friedman/Friedman, 1990: 115).

For Friedman, whether government can conduct an activity more economically than private enterprise it is not even worthy of discussion. Friedman even argues that free market decreases inequality among people. For Friedman, market is a panacea and any state intervention is detrimental to the economy.

Theoretically speaking, there were three possible outcomes of the Cold War. The first one could have been a total triumph of communist ideology around the world. A song that was produced by communist propaganda had the following lines (in Croatian): *Amerika i Engleska bit će zemlja proleterska.*[4] Orthodox communists expected not only the survival of communism in existing communist countries but also an outbreak of communist revolutions around the world. The second possible solution could have been a convergence between capitalism and communism, a sort of mixed system that incorporates the advantages of both systems. However, according to Fukuyama the third possible outcome prevailed – the full triumph of liberalism. "The triumph of West, of the Western idea, is evident first of all in the total exhaustion of viable systematic alternatives to Western liberalism" (1989: 5). Even though Fukuyama overlooked some

[4] America and England will be countries ruled by proletariat. Above, it was written in Croatian because of rhyme.

historical facts,[5] there is no doubt that, at the end of 1980s, the idea that liberal capitalism is the best solution prevailed once again. The collapse of communism in Eastern Europe and the Soviet Union provided a crucial argument that state intervention in the economy is harmful. According to the World Bank, "the collapse of the Soviet Union – by then no longer an attractive model – sounded the death knell for a developmental era. Suddenly, government failure, including the failure of publicly owned firms, seemed everywhere glaringly evident. Governments began to adopt policies designed to reduce the scope of the state intervention in the economy. States curbed their involvement in production, prices and trade" (1997: 23).

As a result, many countries reduced government expenditure on education, health care and infrastructure. State owned enterprises started to be privatized. In developing countries, central government expenditure decreased during the 1990s (The World Bank, 1997: 2). The triumph of liberal capitalism was almost omnipresent.[6] Even Russia accepted the idea of a minimal state role in the economy. Instead of having too strong a state, Russia started to have a weak state incapable of providing basic services. Holmes describes the consequences of this situation: "Ironically, Russians today have more reasons to worry about the debility of state than about its power (...) Total tax revenues as a percentage of gross domestic product hover somewhere below 10 percent (...) compared with roughly 30 percent in the United States and an average of 45 percent in Eastern Europe" (1997: 66-7).

The negative consequences of imposing laissez-faire capitalism started to be especially evident in Eastern Europe. To illustrate, 168 million people in Eastern Europe are now in poverty in contrast to 13.6 million before the fall of communism (The World Bank, 1999: 7). In Russia, from 1989 to 1994, male life expectancy dropped from 64.4 to 57.3 years (Heleniak 1995, 1-5). Male life expectancy fell in half the transition countries in the early postcommunist era (Murell, 1996: 40). In addition, from 1991 till 1993, the death rate increased by 26 percent and the infant mortality rate increased by 4 percent (UNICEF, 1993). The decline in life expectancy was predominantly a result of malnutrition. In Moldova, between 1990 and 1996, there was a decline in the per capita consumption of meat by 57 percent, of milk and dairy products 48 percent and of sugar 60 percent (Beams, 1999). The negative consequences of imposing laissez-faire capitalism started to be evident not only in Eastern Europe but also in Africa and in Latin America. Some investigations showed that the revival of liberal capitalism had negative consequences even in the USA. According to Thurow (1996: 22), social inequalities in the USA are now similar to the period before the Great Depression. As a consequence, average median earnings for males fell 11 percent in the 1990's compared to the 1970's. Greater social inequalities produced higher rates of crime. The USA, a country with the greatest social differences among industrialized countries, also has one of the highest rates of crime. An American citizen has a 14 times higher probability of being murdered than a Japanese citizen and an American woman faces a 29 times higher risk of being raped than a woman in Japan. An American also has 146 times higher probability to be a victim of robbery than a Japanese (Lipset, 1996: 227). Yet, among industrialized countries, Japan has one of the strongest and the USA one of the weakest roles of the state in the economy.

[5] For example he overlooked the fact that, in 19th century, it was Marxists who fought for universal suffrage and liberals were against. Therefore, triumph of democracy in Europe is, in a way, a triumph of social-democratic variance of Marxism.

[6] Even though China exposed itself to world market and foreign investments, China did not follow dominant trends.

To give an additional example, the USA has, among industrialized countries, the lowest percentage of public share of total health spending. Contrary to Friedman's prediction, this fact did not decrease expenditures for health care. In 1990, the USA spent 12.5 percent of national GDP on health care. In contrast, in Japan, where government covers health expenditures, only 7 percent of GDP was spent on health care (The World Bank, 1993: 110).[7] However, life expectancy was, in 1990, 79 years in Japan and 75 years in the USA. Furthermore, black people in the USA have lower chance of reaching mature ages than do people in China, Sri Lanka and in some parts of India (Sen, 2000: 6). Contrary to Friedman's assertion, it is not difficult at all to find an activity that is conducted more economically by government than by private enterprise – health care.

Failures of liberal capitalism provoked, once again, a discussion about the role of the state in development. Since East Asian countries experienced, in addition to communist countries, the most rapid rates of economic growth, many authors investigated the role of the state in this region. It is interesting that proponents of liberal capitalism claim that the success of the "Asian tigers" is a confirmation that the market, not the state, is the main engine of economic growth. For example, Friedman and Friedman assert: "Malaysia, Singapore, Korea, Taiwan, Hong Kong, and Japan – all relying exclusively on private markets – are thriving (...) By contrast, India, Indonesia, and Communist China, all relying on central planning, have experienced economic decline" (1990: 57). It is barely worthy to discuss whether China experienced economic decline or miraculous economic growth. Introducing reforms but also relying on central planning,[8] China achieved the fastest growth of GDP per capita in the world in the last two decades.[9] However, it is worthy to discuss whether the East Asian success is a result of laissez-fair capitalism or of state interventionism. Here, what is most striking is not the similarity between principles of laissez-faire and the policy of the "Asian tigers" but a similarity between the policy of communist countries and the "Asian tigers". To illustrate, land reform was one of the first measures of communist government in Yugoslavia. Similarly, in Japan, after World War II, "the land reforms (...) brought about the complete elimination of Japan's landed elites" (Alam 1989, 117).

Among all the subtypes of political regimes, communist dictatorships had the highest level of social equality.[10] Likewise, according to Pempel: "A second facet of Japan's unusual policies relates to the nation's broad income equality. For most of the postwar years, Japan was extremely egalitarian (...) The growth of Japanese capitalism did not entail yachts for executives, massive corporate dividends to stockholders, and layoffs

[7] If the USA reduced spending on the health care by 5.5 percent, the USA would save approximately $ 550 billion annually. Each American would have to pay approximately $1,750 less annually for the health insurance.

[8] According to *Business Monitor* (2000: 19-91), non-private sector accounts for more than 2/3 of China's industrial output.

[9] For the 1951-90 period, data about GDP per capita growth are form Przeworski et al. (2000) data set which is available at http://www.ssc.upenn.edu/~cheibub/data/Default.htm. For the period from 1991-2001 data are from CD-ROM *World Development Indicators 2001*, published by the World Bank, and from *World Development Report* 2003 and 2004.

[10] In average during the 1961-90 period, GINI index of inequality was 25 in communist dictatorships, 45 in presidential democracies, 37 in semipresidential democracies, 36 in parliamentary democracies, 44 in military dictatorships and 43 in civilian non-communist dictatorships. (Data about GINI index and classification of regimes are from Przeworski et al. (2000) data set. Classification of communist dictatorships is from Gastil (1981).

and downsizing for the workforce (...) In numerous other areas, such as education, infant mortality crime, health care, caloric intake, and so forth, Japan has been strikingly egalitarian since 1950s (...) It is little wonder that 90 percent of Japan's citizens typically identify themselves as middle class" (1998: 8-9).

Amsden et al. confirm Pempel's findings. Comparing the experience of Eastern Europe and East Asia, they claim that "two key ingredients in East Asia's success have been strongly represented in Eastern Europe in the early stages of transition: high levels of education and income equality" (1994: 15).

Communist countries were criticized for nationalizing their means of production. Liberal economic theory argues that state-owned properties are inefficient. Yet, Taiwan nationalized, after WWII, Japanese-owned factories. As a result, public enterprises supplied, in 1952, 56.2 percent of gross manufacturing output (Alam, 1989: 73). In Taiwan, according to Evans (1995: 56), "the state enterprise sector not only makes a direct entrepreneurial contribution but is also a training ground for economic leadership in the central state bureaucracy". According to Amsden (2001: 287), public enterprises were, in most cases, the "first movers" of the remarkable growth of East Asian countries.

A liberal dogma is that state intervention in the market leads to economic inefficiency.[11] In contrast, Peter Evans' book *Embedded Autonomy* (1995: 48) shows that activist, positive role of government could be a decisive factor in rapid industrial growth. The author showed that the economic success of Japan, Taiwan and Korea have been the result of a very active role of state in promoting economic and social development. In Japan, the Ministry of International Trade and Industry (MITI) was "the greatest concentration of brainpower". As a result, "Japan's developmental state was a central element in explaining the country's post-World War Two economic miracle" (Evans, 1995: 47-8). Similarly, in South Korea, the state bureaucracy recruited the most talented students from the best universities. This bureaucracy conducted various activities: financing of public education[12] and public health, investing in infrastructure, constructing comparative advantages to compete in the world market, financing irrigation systems and fertilizers, protecting infant industries, financing science and technological development, etc. Governments even invested in public enterprises. In Taiwan, the percentage of gross domestic investment originating in public corporations and government enterprises was between 23 and 40 percent during the 1951-73 period (Alam, 1989: 61).[13] In addition, it is possible even to find similarities between political systems in East Asia and in communist countries. According to Alam, "the concentration of power and the stability of leadership that we observe in these two countries [Taiwan and S. Korea – M. A.] are indeed rare outside of the communist countries" (1989: 21).

It is interesting that the above mentioned authors barely referenced the Soviet Union and Eastern Europe. After 1990, for the authors who analyzed the success of the state in promoting development, this region was unimportant. There was almost a consensus among western economists and political scientists that Eastern Europe and Soviet Union can only be considered as examples of state failures. So, are communist countries a

[11] See, for example, Friedman/Friedman, 1990; Hayek, 1994; *World Development Report*, 1991; Amsden et al, 1994: 213-4.

[12] For example, at the end of 1980s, there were twice as many engineering students in South Korea as in the United Kingdom (Evans, 1995: 147).

[13] Actually, these figures were underestimated because they do not include investments in enterprises in which the share of state ownership was less than 51 percent.

proof that state interventionism has a harmful influence on economy? If this claim is true than we can expect communist dictatorships (which had the strongest role of state in the economy) to be the least successful in promoting economic growth. Since 1951 it is possible to measure rather accurately GDP per capita growth. Therefore, it is possible to check empirically success of different types of regimes. Data in Table 1 show, to say the least, that state interventionism did not have a harmful influence on economic growth in communist dictatorships. And this trend still continues. Two out of three fastest growing economies in the world, during the 1990-2002 period, are communist dictatorships – China and Vietnam (see *World Development Report*, 2003: 238-9; *World Development Report*, 2004: 252-3).

Table 1. GDP per capita growth[14] in different subtypes of political regimes (1951-99)

Regimes[15]	**Average (%)**
Non-communist dictatorships	1.58
Communist dictatorhips	**4.01**
Presidentialism	1.11
Semipresidentialism	1.69
Parliamentarism	2.50
Dictatorships (total)	1.77
Democracies (total)	**1.99**

Analyses in this article show that communist countries were similar to East Asian countries not only concerning economic policy but also developmental achievements. This article also shows that an active role by the state has beneficial effects on economic and social development not only among "Asian tigers" and in Western Europe but also in communist countries. However, one fact can not be disputed – communism disappeared entirely from the place of its origin. It would be out of the scope of this article to present all – or even the most important – factors that caused collapse of communism in Eastern Europe. Still, there is no doubt that massive production in these countries was not in accordance with demands, especially concerning quality of products. Therefore, the history of communist regimes can be proof for both that an active role by the state spurs economic growth and that a too weak market system may produce a collapse of the regime. The main advantage of East Asian countries, in comparison to East European countries and the former Soviet Union, is that the market complemented the activities of the state. According to Amsden et al, "the state should not be opposed to the market, but should be treated as complementary to it" (1994: 180). Therefore, the ex-

[14] As it was mentioned above, data about GDP per capita growth are from Przeworski et al. (2000) data set. The authors used data about economic growth from Summers and Heston's Pen World Tables. According to Przeworski et al., 2000, Scully, 1992 and many other authors, these tables are the most reliable sources about economic growth available in the literature. Data about GDP per capita growth for the 1991-9 period are from The World Bank, 2001.

[15] Classification of regimes for the 1951-90 period is based on Przeworski et al. (2000) data set. For the 1991-9 period this article uses an unpublished classification of regimes made by Antonio Cheibub. This classification is a continuation of classification that was conducted for the book *Democracy and Development*. I am grateful to Antonio Cheibub for allowing me to use his data set.

perience of communist countries and the "Asian tigers" show that the state needs the market and vice versa.

Furthermore, it is not enough to have an active role of state in the economy. If the state apparatus is corrupted and incompetent, state intervention may produce more harm than good. For example, Bates (1981) found that public institutions in Africa were used for private advantages. Only those who were supportive of government received public funds. Agricultural policies in Africa were harmful to most farmers. Larger farmers were taxed less due to their ties with the governing elite. Any edition of the *World Development Report*, by the World Bank, provides copious examples of government failures. Therefore, there is no wonder that Srinivasan, concluded that developmental state is an illusion. "Dominant view of the early development literature that a benevolent state, acting solely in the societal interest, and equipped with needed information, knowledge and policy instruments, can intervene in an optimal way to correct any market failure and launch a society along the road to self-sustained and rapid development turned out to be much too optimistic, if not completely out of touch with realities. Instead, the state is seen to be pushed and pulled by lobbies and interest groups that are mostly interested in redistribution rather than growth and development" (1985: 45).

However, experience shows that building an efficient and uncorrupted bureaucracy is a difficult but possible endeavor. Max Weber (1978) stipulated, at the beginning of 20th century, the main principles of modern bureaucracy. It is interesting to note that Asia is the place of origin of these principles. According to Ezra Vogel, "the development of a meritocratically selected bureaucracy [is] one of the greatest contribution of East Asia to world civilization" (1991: 93). The experience of these countries shows that bureaucracy could be not only interested in promotion of growth and development but even the main actor of this promotion. To be capable of formulating and implementing development plans, bureaucracy must be, according to Waldner, "endowed with certain organizational resources, including meritocratic norms of recruitment and promotion to ensure that agency is staffed with the requisite talent (...) and insulation from pressure groups to ensure depoliticized decision making" (1999: 42).

One additional issue might also challenge state interventionism – globalism.[16] According to Thurow, "in a global economy if a country is a high-tax, high-spending society, say Sweden, business will simply move to low-tax, low-spending society (...) to avoid taxes and Sweden will be left without the tax revenue necessary to finance the level of service that its voters might want" (1996: 130). There is no doubt that state interventionism is expensive. However, the absence of state interventionism is frequently even more expensive. To illustrate, the free market produces enormous social inequalities and these inequalities breed high rates of crime. Fighting against crime may be even more expensive than financing social programs, like education, that decrease social and economic inequalities. According to Thurow (1996: 84), "California's prison budgets were double those of its universities, with state expenditures per person in prison four times as high as expenditures per person in its universities". In addition, Rodrik (1997: 25) found positive correlation between a nation's openness to trade and the amount of its spending on social programs. A welfare state is more capable to annul negative consequences of openness to the international economy. Resistance to globalization is stronger when people cannot count on governmental support if they lose jobs as a result of foreign competition. In addition, state interventionism may increase competitiveness of an economy at the world market. The East Asia is the prime example. Therefore,

[16] For globalization debate see Mander/Goldsmith, 1996; Giddens, 2000; Gilpin, 2000.

there is no reason to believe that laissez-fair economy is more complementary to globalization than welfare state.

Fukuyama (1989) was correct claiming that the end of the 1980's was a complete triumph of liberal ideas. However, it is possible that the 21st century will be a triumph of the theory of convergence. During the period of Roosevelt's presidency, the United States started to be the most powerful economic and military power in the world. In the last quarter of the 20th century, China was economically the most successful. The New Deal and economic reforms in China have – in spite of their significant differences – one thing in common. In both cases liberalism was combined with state interventionism. It was not by chance that Roosevelt was criticized for bringing socialism in the USA. According to Thurow "Roosevelt designed the social welfare state that saved capitalism after it collapsed in America (...) Socialism was invented shortly after capitalism as a remedy to the visible nineteenth-century defects of capitalism – widening inequalities, rising unemployment, a growing workforce of castoffs" (1995: 4).

Economic reforms in China opened it to foreign investment, strengthened the role of the market and enabled private initiatives. In a word, China introduced some elements of capitalism. Of course, this article does not argue that the balance between socialist and capitalist elements was equal during the policy of New Deal in the USA as it is in modern China, but it does argue that in both countries reforms produced a sort of successful convergence of both systems. Furthermore, state interventionism produced excellent results in East Asian countries. Finally, West Germany, a country established on the principles of a welfare state, was the most successful one in promoting economic growth in the Western Hemisphere after World War II.

At the beginning of 1990s, East European countries and countries in the former Soviet Union started to transform their economies into market economies. After thirteen years of transition half of the countries in the region are still not capable to achieve the same level of economic development which they had at the end of communism. An average annual rate of GDP growth in the region, during the 1990-2002 period, is -.6 percent (*World Development Report*, 2003: 238-9; *World Development Report*, 2004: 252-3). Hence, Amsden et al. are right claiming that the economic hardships in Eastern Europe and the former Soviet Union "can be attributed both to the blanket rejection of any remnant of the immediate socialist past and, further, to the embrace by almost every country in the region of a simplistic capitalist experiment… Allowing first-rate firms to go to bankrupt and world-scale research and development laboratories to deteriorate has delayed not just catching up with the world's richest countries but recovering pretransition income levels by several years (...) East Europe's below-potential performance (...) has stemmed from copying the wrong capitalist model (...) The local true believers in the market were fortified by advisers from Western Universities, the World Bank, and the International Monetary Fund. They pushed reforms in predictable directions, minimizing the role of the state and postulating that uncontrolled markets are an infallible guarantee for robust output growth. These ideas follow from a fundamentalist reading of mainstream, neoclassical theory, which flourished during the administrations of Presidents Reagan and Bush" (1994: 2-4, 18).

In other words, it was not the transition as such that caused the economic hardships in the former communist countries but an inappropriate model of transition. Countries in this region changed not only the bad elements of communism – lack of freedom and individual initiative – but also its advantages – low level of inequality, universal health care, active role of state in economy, etc. Therefore, it can be concluded that prudent and comprehensive state interventionism would have produced better results than the model of capitalism that was introduced after the collapse of communism. But this is not only the experience of East Europe. Since the Great Depression, almost all the countries that had high rates of economic growth based their successes on state interventionism. Therefore, it is important to reexamine, once again, the role of the state in promoting development.

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