WHAT IS A STATE?

A state is a politically-bound space within which the resident population is governed by an authority such as the government. The term ‘the state’ can also be used to refer to the government, which we will be doing so for this topic.

WHAT ARE THE MAIN OBJECTIVES OF THE STATE?

The state has 2 main economic objectives for intervention in the economy:

Promote economic development and raise the standard of living in the country.

Reduce social economic disparities within the country (either between social groups or between regions in the country so as to ensure peace and political/economic stability.

(A) STATES AS REGULATORS OF ECONOMIC ACTIVITIES AND TRANSACTIONS

States play a role in the economic development of a country by regulating how their economies operate as they attempt to control what happens within and out of the country. This is done by:

(i) Influencing the country’s industrial structure

The state can promote economic development by influencing the industrial structure of the country to become more focused towards manufacturing and service industries.

(a) Rural development policies

Firstly, the state may implement rural development policies which aim to improve economic productivity of the primary industry. This is done through:

i. Land redistribution by the state – to maximise landuse
ii. Mechanisation of agriculture industry – to allow release of labour to work in nearby industries
iii. Structural reforms to encourage a market-oriented agricultural system – to change from subsistence farming to production for sales

For example in Guangdong province of China, the abundant labour supply due to modernisation of agriculture has provided an incentive for TNCs to invest branch assembly plants in the region.

(b) Encourage development of manufacturing and service industries

Secondly, the state can also encourage development of manufacturing and service industries, which provide higher returns than agriculture. This is achieved by stimulating particular industries and restraining others through the usage of taxes and subsidies, as well as legislation.

The government does this through enhancing trade and investment policies to attract TNCs. It may encourage investment by reducing corporate tax, giving tax holidays, and investment grants to investors. This lowers business cost and hence improves on the country's export competitiveness. It may also attract investment and imports by reducing tariffs and providing non-tariff barriers to particular industries it wishes to focus on.

Trade tariffs refer to import taxes which are only applied when trade cross a boundary

Taxes are applied to items either within and across state boundary.

For example, in Singapore, the state offers subsidies for companies involved in biomedical research such as A*STAR.

(ii) Managing trade

Depending on a country's economic policy, the state may seek to either restrict imports or promote exports in order to aid economic development through:

(a) Import substitution / protectionism

Import substitution is usually favoured by areas with large markets. A state may choose to adopt policies which seek to *restrict imports*, which is also known as protectionism. Protectionism allows local firms to be insulated from overseas competition and thus be able to grow. Measures such as import taxes, quotas and licensing requirements are some ways in which the state can restrict imports.

For example, protectionist measures were adopted in the early years of South Korea's economic development whereby cheabols were developed

(b) Export promotion

In contrast to import substitution, the state may *promote exports* so that its firms can tap into a global market to obtain raw materials as well as sell its products. In this case, the state seeks to reduce barriers to trade by lowering import and export taxes. It will also have liberal regulations on trade. This is favoured by small resource-poor countries which have a limited domestic market. Countries such as Singapore and Hong Kong have successfully pursued this route to economic development.

(c) Manipulation of foreign exchange rate

The state may also manage trade through manipulation of the foreign exchange rate. For example, the Chinese government has tried to keep the value of the Chinese Yuan low to make its exports cheaper and thereby more competitive. On the other hand, the Singapore government has kept the Singapore Dollar strong in its effort to keep the cost of imported raw materials low for its manufacturing sector.

(B) PROVIDING GOOD PUBLIC INFRASTRUCTURE AND HUMAN CAPITAL TO ATTRACT TNCS

In order to raise economic competitiveness, the state seeks to develop comparative advantages and attempt to reduce business costs to attract investments. This is achieved by:

(i) Infrastructure development

The development of infrastructure such as **transportation and communications systems** facilitates the growth of manufacturing and services. It reduces the need for TNCs to invest in infrastructure required for its operations and facilitates smooth transport of goods and services hence attracting investment.

For example, the development of the port of Singapore has contributed to the rapid growth of the manufacturing and service sectors. The Singapore government has also provided infrastructural support for the biomedical industry through the development of the Biopolis, a complex dedicated to biotechnology research.

(ii) Developing human capital

The development of human capital through the implementation of social policies which seek to improve the quality of the labour force makes the country attractive to investment as it enable the people to better support the functions of firms' operations. Social policies involve improvement of healthcare to improve standard of living and education to equip the workforce with relevant knowledge and skills to support local economy.

In this way, the states are also the key providers of their countries' **health and education services**. Health services attempts to ensure that the workforce is physically adequate to be economically productive. Education infrastructures such as schools, vocational and tertiary education institutions help to equip the workforce. This increases the country's attractiveness to TNCs as TNCs would be able to engage the workforce without having to invest in developing the human capital to support its operations.

The rapid growth of the first-generation Asian NIEs such as Singapore, Hong Kong and Taiwan owes much to the states' focus on educating the population.

For example, Singapore's education system has evolved to cater to the global demands. To create opportunities for school leavers and adult learners to acquire skills, knowledge and values for employability and lifelong learning in a global economy:

- 1960s – 1970s: Vocational education and training was emphasized to support the focus on manufacturing industries in Singapore
- 1980s – early 1990s: Information and Communication Technology (ICT) and innovation was emphasized to support the shift in economic focus from a labour intensive economy to a capital and skill-intensive economy in Singapore
- Late 1990s – now: Critical thinking skills was emphasized to prepare its workforce for the world economy which is shifting to become a global knowledge economy

As Singapore evolved from an economy based on port and warehousing activities, through a low-wage, labour-intensive manufacturing economy, and then to a more capital and skill-intensive industry and finally to its current focus on knowledge intensive industrial clusters, the education system evolved to ramp up the quality of its education and the supply of specific skills needed to make Singapore globally competitive.

(iii) Managing investment

The state enhances its country's economic competitiveness by encouraging both domestic and foreign direct investment via incentives and regulations.

(a) Domestic investment

The state may provide tax incentives and subsidies to local firms to make them competitive on a global scale. This policy seeks to create "national champions" – firms that are symbols of the country's economic might. Examples of these include the huge subsidies given to Korean conglomerates such as Hyundai in the 1960s by the Korean government. A more recent example is the support of the Malaysian government for the local auto-maker Proton.

On a less extreme scale, the state may also use a mix of tax incentives, subsidies and regulations to encourage investment in key strategic industries which are identified as having great potential to drive the country's economic development. Increasingly, the focus of the state in Developed Countries and Newly Industrialised Economies is towards the promotion of high-technology industries. The state sought to do this through establishment of purpose-built industrial areas such as Science Parks, Techno Parks or Business Parks,

<u>**Science Parks/ Techno Park**</u>

A **Science Park or Techno Park** is an agglomeration of buildings dedicated to scientific research whereby products of the research are commercialised. They are commercial enterprises characterised by:

- Direct links to universities and major centres of research for transfer of technology and business skills on site.
- Geographical proximity to universities and usually located on greenfield sites or out-of town locations to allow for spatial expansion
- Firms are mostly small and medium size enterprises as economies of scale are of little importance.

Such agglomeration of science and research firms allow for benefits such as

- Gains of ***traded and untraded interdependencies*** for sharing and development of research, products or even businesses.
- Revenue for the universities, as well as avenues for students and academics to undertake 'real world' research.
- Developing the local economy through direct and indirect employment, strengthening of local industry, diversification of industry and attraction of inward FDI.

> Science parks are designed to attract high-tech investment into a country and to spur tech progress. This is particularly relevant as the development of tech as a product is now one of the most lucrative activities.

An example is the Singapore Science Park located near the National University of Singapore. It is managed by Ascendas and developed in 1980 to provide infrastructure for R&D to flourish in Singapore.

Another example is MSC Malaysia, formerly known as the Multimedia Super Corridor of Malaysia. Inaugurated in 1996, it is located in Kuala Lumpur, Malaysia and includes the town of Putrajaya and Cyberjaya. Government incentives include a 5-year tax holiday, no quotas on the number of foreign staff being hired by firms, the possibility of firms to be 100% foreign-owned. It also seeks to attract investors through facilities such as high-speed Internet access and proximity to the Kuala Lumpur International Airport.

Business Parks

A Business Park is an agglomeration of commercial activities on one large landscaped site whereby buildings consist of units of offices, high tech firms or research establishments. Unlike a Science Park, it does not have a direct link to universities. A business park is characterised by:

- Close proximity to transport routes such as highways and airport
- Greenfield sites at rural-urban fringe to allow for spatial expansion
- Infrastructural support, 'hard' business services which allow for business operation (e.g. conference rooms, equipment, security, reception service etc.) and 'soft' business services for company development (e.g. marketing, technology transfer, student attachment etc.)
- May include hotels, leisure activities such as restaurants, health and fitness centres etc. so as to provide a comfortable environment for the business partners

Biz parks are designed to complement the fact that many business operators may not have the local economy as the focal point and hence no need to locate within CBD where land-cost is high.

An example of is Cheadle Royal Business Park in South Manchester, one of UK's finest business parks. It is located close to Manchester Airport and its tenants include Umbro, Whitbread and Independent Insurance. Other than business facilities, Cheadle Royal also has other businesses such as David Llyod Racquet and Fitness Centre, Travel Inn Hotel and TGI Friday's Restaurant. What makes it attractive is that it s includes amenities and everyday facilities the staff would normally expect in a town centre. (Refer to Geofile 489: Business Park Location)

(b) Foreign Direct Investment (FDI)

In general, the state seeks to attract both inward and outward FDI by TNCs as FDI generates employment and income in the economy.

Inward FDI involves a foreign company investing or purchasing goods in the local economy.

Outward FDI involves local investment or purchase of goods from an external company.

Despite encouraging both inward and outward FDI, the state also seeks to limit the negative impacts of TNCs on the domestic economy. One way to achieve both objectives simultaneously is to encourage FDI in export industries, such that the goods produced have minimal impact on the domestic economy. One of the key ways states achieve this is through the setting up of Export Processing Zones.

Export Processing Zones (EPZs)

EPZs are designed to capitalise on employment, technology and capital that TNCs bring without having to outcompete domestic firms.

Export Processing Zones (EPZs) are industrial zones with special incentives set up to attract foreign investors, in which imported materials undergo some degree of processing before being re-exported. They include free trade zones, special economic zones, bonded warehouses, free ports and customs zones. They are characterised by:

- Transport and communications infrastructure to support manufacturing industries
- Labour intensive manufacturing centres involved in import and processing of raw materials and export of products
- Products cannot be sold within the host economy – this is to protect domestic market from competition by TNCs
- Government incentives such as the elimination of customs duties on imports, liberalisation of capital flows to promote inward FDI, reduction/ exemption of corporate taxes on firms operating within EPZs. These are done to attract TNCs

More than 90 countries have established EPZs as part of their economic strategies or as a path to industrialisation. The number of EPZs has grown rapidly in the last 20 years because of 3 main reasons:

1. States wish to increase economic growth through TNC involvement, but at the same time want to control the effect of TNC FDI on the local economy.
2. The spread of trade liberalisation ideas in the 1990s encouraged open economies and FDI.
3. The advancement in technology enabling the decentralisation of production through NIDL.

Examples of EPZs are the Special Economic Zones (SEZs) in Eastern China and the maquiladoras of North Mexico where labour cost in Tijuana is 1/5 that of San Diego in US. (Refer to supplementary reading on Maquiladora development in Mexico).

(C) CAN STATE COMPETE WITH TNCS?

States are involved as business owners and investors by attempting to be more directly involved in the global economy, hence contributing to governing the global economy.

(a) States as business owners

States function as business owners via various means:

State-owned enterprises (SOEs)

State-owned enterprises (SOEs) are public firms that are *directly managed and owned by the state (but may not be 100% owned by states), and are primarily responsible to construct infrastructure or manufacture products to drive industrialisation and economic growth.* SOEs are particularly important when the private sector is unable or unwilling to invest in certain activities that are essential for development (e.g. construction of infrastructure; production of necessary inputs to other industries, such as steel). Private sector firms may be unwilling because they lack funds or it is too risky (e.g. they do not know if there will be demand for their products).

One good example of a SOE is the Chinese National Offshore Oil Corporation (CNOOC), one of China's largest state-owned oil companies that was founded in 1982 with its headquarters in Beijing. In 2009, CNOOC's level of employment was 66,000 people and generated about US$32 billion in annual economic gains. The majority stakeholder that holds 70% of shares in the company is the Chinese state, and the latter dominates in decision-making process in the appointment of the company's top management staff.

The presence of SOEs are prevalent in many developing countries world-wide where the state concentrates on direct state ownership and management of business firms to pursue its developmental goals. Some examples of SOEs in both DCs and LDCs are:

	Country	Company (State Owned Enterprise)
LDCs	Brazil	Petrobas
	China	China Ocean Shipping
	India	Indian Railways
	Malaysia	Petronas
	Mexico	CFE (an electricity monopoly firm)
	Russia	Gazprom
DCs	Italy	Enel (electricity)
	Norway	Statoil
	Sweden	Systembolaget (alcohol)
	U.S.	Amtrak

[Coe, N.M.Kelly, P.F., & Yeung, H.W.C.(2007), '*Economic geography: a contemporary introduction*', Oxford: Wiley Blackwell]

Government-linked corporations (GLCs)

Government-linked corporations (GLCs), on the other hand, refer to profit-driven business enterprises whereby the state has a direct or indirect stake in the corporation but do not control the management of business operations – instead, professional managers will be recruited to manage the business operations. In GLCs, there is also much lesser degree of intervention in business management as compared to SOEs. Hence, the main difference between SOEs and GLCs are that for the latter, the state does not own any controlling share in the companies and does not dictate the way that the business is managed.

GLCs are usually found among the largest TNCs in the various economies shown in the below table.

Country	Company (GLCs)
Malaysia	the MUI Group
Hong Kong	China Resources Enterprise
Singapore	Singapore Airlines
Taiwan	Taiwan Semiconductor Manufacturing Corporation
Italy	Renault (Car Manufacturing)
France	Fiat (Car Manufacturing)

[Coe, N.M.Kelly, P.F., & Yeung, H.W.C.(2007), '*Economic geography: a contemporary introduction'*, Oxford: Wiley Blackwell]

GLCs play a key role in the globalised world as in many cases, they are the main driving forces of Global Production Networks (GPNs). A good example when Singapore's government successfully fostered large scale outward investment in its regionalisation drive across Southeast and East Asia through GLCs like the Keppel Group, the Sembawang Group and Singapore Technologies

<u>States as containers of distinctive cultures and practices</u>

Each country or region has its own unique cultures and practices which may act as comparative advantages that attract TNCs' investment. The state plays an important role of containing these distinctive cultures and practices to enhance investment.

For example, the Asian work ethic is an attractive feature for TNCs as Asians are generally known to work hard and for long hours. This coupled with the cheap labour cost in many NIEs or LDCs in Asia makes it attractive to TNCs as it increases productivity at lower cost. In contrast, the ability to have a flexible work environment with greater work life balance in West attracts expats who seek greater flexibility in their work. This promotes creativity and innovation especially required for organisational and product development. The ability of states to promote such unique cultures and practices enhances its country's attractiveness.

<u>HOW DO STATE INFLUENCE TNCs and HOW DOES IT VARY?</u>

Do remember that not all states are the same and not all TNCs are the same.

States can have a **direct influence on TNCs** if they are government linked corporation or if the TNCs require help and support from states. For example in the 2008 economic crisis, the US government bailout many large TNC such as Citigroup, Bank of America.

More recently during Covid, the Singaporean government through Temasek Holdings loaned SIA (Singapore Airlines) $13 billion to sustain itself through the pandemic. These loans can come with conditions and will give the state more bargaining power over TNCs.

States can also ban TNCs from operating in their countries such as in the case of China which want to boost it's own domestic tech firms and ban TNCs such as Alphabet (Google) or Meta (Facebook) from operating in its country.

For States that are very reliant on TNCs especially for job provision, TNCs would have more bargaining power over the state. For instance Samsung accounts for around 28% of Vietnam GDP as of 2019, this also entails that the Vietnamese government is afraid of Samsung being a footloose TNC simply living the country which will result in high rates of unemployment. Thus although there is an OECD rule for countries to raise corporate tax to 15%, Samsung and other foreign TNC are pushing Vietnam to introduce a multi-million-dollar reform that would compensate them for higher levies they face.

(E) HOW EFFECTIVE HAS THE STATE BEEN IN MANAGING A COUNTRY'S ECONOMIC DEVELOPMENT?

There are varying degrees of effectiveness of the state in economic development. In NIEs such as South Korea and Singapore, state intervention has been relatively successful in bringing about sustained growth, such that these countries have achieved income levels comparable to those of DCs. However, in other countries, such as Zimbabwe, state intervention has met with less success.

The effectiveness of the state is dependent on:

1. Ability to increase employment and GDP
2. Ability to increase FDI and trade through state policies and collaboration with SNOs and/or TNCs
3. Ability to improve standard of living of population
4. Evenness in distribution of wealth in the state economy

CASE STUDY 1: SUCCESSFUL STATE INTERVENTION IN ECONOMIC DEVELOPMENT OF SOUTH KOREA

Role of state

The Korean government influenced economic development in a number of ways.

1. Land reform of 1948 – 1950 allowed for redistribution of Japanese-owned and state properties to well-connected individuals which helped to create a new Korean entrepreneurial class.
2. There was creation of a powerful economic bureaucracy, with a key role played by a new Economic Planning Board (EPB). Nationalisation of banks and their control by the Korean government allowed the state to intervene actively in the state's economy.
3. The state encouraged the development of the chaebol (a small number of extremely large and highly diversified firms, including Hyundai Samsung, Daewoo, Lucky Goldstar) by consistently favouring them through their access to finance, subsidized loans and very strong, long term relationships were developed between them and the state. The State further supported these chaebol by reducing labour militancy and keeping wages low. At the same time, it implemented protectionistic measures to reduce inward FDI.
4. The Korean government also implemented control over the state's industrial development by including financial subsidy for preferred firms and protection against external competition. This allowed specific shifts of sectorial focus from consumer products in the 1960s to chemicals, petroleum and steel and, subsequently, to automobiles, shipbuilding and electronics in the 1970s and high-tech industries post-1980s.
5. The state encouraged technological development through purchase of technology from overseas and adapting it to fit the Korean economy. Korea Institute of Science and Technology and Ministry of Science and Technology were established to function to facilitate research and development activities.
6. During the 1990s, the formerly tightly controlled financial sector was significantly liberalized.

Evaluation

Despite implementation of protectionism to reduce FDI up till 1983, Korea was successful in encouraging economic development. The above action by the state allowed for gross national product (GNP) to grow by an average of 8.4% per annum from 1963 to 1983. By late 1980s, GNP growth rates were reaching 12% per annum. Korea's high rate of economic growth has been sustained by expansion of exports which grew from $40 million in 1953 to $195 billion in 2003. Annual growth rate in the 1960s was 38%. The wise economic management enabled these targeted growth of local firms. The conglomerates within the Chaebol grew from almost nothing to world-scale organisations within a span of 30 years which allowed for high economic growth.

However, the intervention of the state in the growth of the South Korean economy has not been without its problems.

The policy to keep wages low resulted in uneven distribution of wealth in the economy. In 1986, the average worker earned US$381/month, two-thirds of what the government thought necessary to sustain a family of four (US$588/month). This inequality resulted eventually in considerable labour unrest. There were more than 300 strikes in the first three months of 1989.

Since 1989, there have been dramatic increases in wages throughout the entire economy. While this has been welcomed by workers, it has led to a reduction in competiveness of exports on the global market.

The government support for the chaebol has also resulted in an unbalanced industrial structure with few small and medium enterprises. Their protection has also allowed for inefficiencies to set in. There have also been accusations of corruption. There have been attempts since 1988 to change the practices of the chaebol but with only limited success. To date, the greatest need is to reform the chaebol, which had come to distort the economy and which were, themselves, in great financial difficulty due to excessive borrowing.

CASE STUDY 2: UNSUCCESSFUL STATE INTERVENTION IN ECONOMIC DEVELOPMENT OF ZIMBABWE

Role of State

Zimbabwe gained independence from British rule under Robert Mugabe in 1980 and at that time, Zimbabwe's economy was dominated by a successful commercial agricultural sector, dominated by the white minority whereby Zimbabwean whites who were effective at commercial farming, although making up less than 1% of the population, owned more than 70% of the arable land, including the best land in the country. The government

1. Executed land reform programs whereby lands belonging to Zimbabwean whites could be purchased by the government and redistributed to Zimbabwean blacks who had little knowledge about commercial farming. In 1992, the Land Acquisition Act was amended to give the government forceful rights to buy land and evict White farmers.
2. In 2007 the Empowerment Bill was passed which required all White or foreign owned business to hand over 51 percent of their business to indigenous Zimbabweans.
3. To combat high rates of inflation which exceeded 2000% in 2007, the state attempted to introduce price control (by having locals sell goods at a loss) but implementation was largely unsuccessful.

Evaluation

The state's action to implement land reform had been largely detrimental to not only the economic but also social and political development of the country. It led to a collapse of the commercial farming sector which is believed to have caused widespread famine resulting in starvation and death. 45% of the population is considered malnourished.

The mismanagement of the primary industry impeded economic progress. Poverty rate in Zimbabwe is about 80% and it has a 95% unemployment rate. There is also great disparity in wealth within the country whereby the bottom 10% of the Zimbabwe population represents 1.9% of the economy while the top 10% represent 40.42%.

There was also lack of economic and social progress due to corruption. For example, the implementation of land reformation has been characterized by chaos and violence causing many to flee the country. The land seized by the government has, in many cases ended up in the hands of Mugabe's supporters, while the rest of the country has gained little. Since the implementation of the most recent land reforms of the 4,500 commercial farmers, only 300 remain on farms. Such political and social instability has also resulted in reduced foreign tourism, costing tens of millions of dollars a year in lost revenue.

CONCLUSION

Hence, states tend to shape profoundly the economic activity within and across their borders in a wide variety of ways, from the provision of education and infrastructure, to direct ownership of companies and through the implementation of a range of financial and tax incentives. Although states have widely differing abilities both to control their economies and to exert influence over supranational organisations, the governments play an extremely important contributor to the economic development of these countries. Together with TNCs, they are the architects, rather than passive contributors to the economic development of these countries. However, wise leadership allowing the state act as effective economic regulator, competitor, container of culture and collaborator with other states is required to ensure economic and social development.