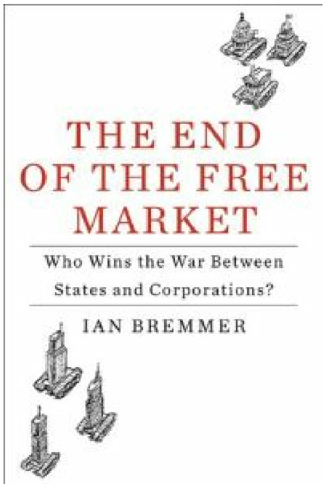


# Book The End of the Free Market

## Who Wins the War Between States and Corporations?

Ian Bremmer
Portfolio, 2010

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## Recommendation

No truce appears on the horizon in the battle between government control and free markets, a conflict that has intensified in the aftermath of the 2008-2009 recession. Political strategist Ian Bremmer examines the differing models of "state capitalism" that have gained ground in emerging economies around the world. Using varying levels of political control, countries such as China, Russia and Saudi Arabia are adapting the capitalist scenario to their particular situations and needs, thereby presenting obstacles to a fair fight with Western businesses. While decrying the unfair advantage governments bring to successful emerging economies, Bremmer concedes that free markets alone can't solve all society's issues, and he advocates for "better government, not less government." *BooksInShort* recommends this thorough, cogent study to global business executives looking to understand and compete in state-capitalist countries.

## Take-Aways

- The 2008 financial crisis succeeded in reviving "state capitalism" around the world.
- All nations use varying levels of state involvement to help their economies and citizens.
- Emerging markets have grown by using government ownership and influence to gain business, often at the expense of privately held Western companies.
- State-owned or -allied companies such as Mexico's Cemex and Brazil's Petrobras are climbing up the lists of the world's biggest, most valuable companies.
- Free-market countries' default position calls for minimal state intervention.
- State capitalists believe the interests of "ruling elites" override those of their citizens.
- Saudi Arabia's monarchy ensures its political continuity through its oil wealth.
- The Russian state applies its muscle to keep private business owners in line.
- To remain in power, China's leaders must "create millions of new jobs each year."
- Private Western companies should exploit their greater agility and innovation to compete with their state-controlled rivals.

## Summary

### Back to the Future

Public ownership of private enterprise had a dramatic resurgence in the first decade of the 21st century. Despite the widespread belief that state-controlled economies were on their way out with the fall of communism in the late 1980s, the 2008 financial crisis has resulted in a revival of government intervention, investment and financing in many of the world's banking and industrial sectors. In addition, the blossoming of the G7 bloc into the G20 group means that what was once a coalition of firm "champions of free-market capitalism" has morphed to include "relative free-market skeptics" such as Russia, China and India.

> "Globalization, like capitalism, is powered by the individual impulses of billions of people. It...can't be reversed by decree."

What does this mean for Western capitalism? Other nations see the US as the origin of the 2008 crisis and the ensuing recession, which quickly moved worldwide. The US and Europe had to intervene rapidly and massively to protect their financial systems from collapse. Western nations bailed out and effectively nationalized banks, insurance companies and car manufacturers. The huge infusion of public money into private companies gave free-market skeptics an opening to question the viability of US and European capitalist hegemony; they blame free markets for the crash and point to the West's inability to right its economies and prevent panic.

## "State Capitalism"

While the second half of the 20th century saw the rise of a multinational challenge to the sovereignty of the nation-state, subsequent events have turbocharged an old economic player: businesses "owned or closely aligned with their home governments." State-owned or -allied companies such as Mexico's Cemex – the world's third-largest cement manufacturer, equivalent in value to Coca-Cola – are rising on the lists of the world's biggest, most valuable organizations. Brazil's Petrobras and Russia's Gazprom are among the planet's largest firms. Government-owned China Mobile boasts the world's greatest number of cellphone users – 488 million. China controls three of the globe's four biggest banks and three of its five largest corporations.

> "Forced to choose between protection of the rights of the individual, economic productivity and the principle of consumer choice, on the one hand, and the achievement of political goals, on the other, state capitalists will choose the latter every time."

Mexico, Brazil, Russia and China follow state capitalism, a variant of commercial enterprise that maintains political control over some or all parts of the economy. This "form of bureaucratically engineered capitalism" is "particular to each government that practices it." Resource-rich countries such as oil producers tend to retain economic and political control of their strategically important assets. Other states, including China and Russia, over time have adapted centrally planned economies to incorporate some capitalist methods and motivations.

> "The fall of communism did not mark the triumph of free-market capitalism because it did not put an end to authoritarian government."

In reality, no country practices unfettered capitalism; most Western nations – even the US, a bastion of free markets – have "'mixed' capitalist economies." These states recognize that private interests alone cannot provide for all of society's needs. In the aftermaths of wars and financial crises, developed nations' governments tend to take a more active, albeit usually temporary, economic role. Yet these countries' default position is that open markets are the best way to "generate long-term prosperity" and that state intervention in economic operations should remain minimal. In comparison, the leaders of state-capitalist nations see government economic involvement as "a strategic long-term policy choice" that advances the interests of the state's "ruling elites" over those of individual citizens. This intervention creates inefficiencies and distortions that manifest as a disadvantage for the rest of the world.

## The State-Capitalist Apparatus

Nations use "a variety of intermediary institutions" to manage aspects of their economies and to administer their holdings. Structurally, state capitalism uses four significant tools:

1. **"National oil (and gas) corporations" (NOCs)** – Some state-controlled NOCs are among the world's biggest energy firms, notably Aramco (Saudi Arabia), Petronas (Malaysia) and China National Petroleum Corporation. These three giants and the NOCs owned by Russia, Iran, Venezuela, Brazil, Abu Dhabi and Kuwait lay claim to 75% of the Earth's oil. While the degree of direct political influence that governs them varies, NOCs enjoy competitive advantages over private energy companies: They receive "aggressive" government support, they're allowed to work with "repressive regimes" that private firms must avoid, and they obtain generous funding, enabling them to outbid multinational corporations. Their goal is not to make a profit, but to maintain their nations' political power.
2. **"State-owned enterprises" (SOEs)** – Governments also own firms that manage non-petroleum resources or provide crucial products and services, such as the US's Postal Service, China's State Grid Corporation, which supplies electricity, and Angola's Endiama, which mines diamonds.
3. **"Privately owned national champions"** – Governments spin off these strategically pivotal companies from state-owned enterprises or retain minority ownership in the larger entity. These intertwined relationships remain powerful, and these champions continue to enjoy government support, though it is often covert. Historic examples include Japan's post-World War II *keiretsu*, which spawned Mitsubishi and Toyota. Major national champions include China's computer firm Lenovo and India's Tata Group conglomerate.
4. **"Sovereign wealth funds" (SWFs)** – Monies generated through states' sale of natural resources, via international trade or other government transfers, can funnel into SWFs. These funds invest in strategically pivotal assets, operate largely in secret and answer only to their state handlers. The best-known of today's 50 SWFs include the Kuwait Investment Authority and the extremely large Abu Dhabi Investment Authority. China Investment Corporation recycles foreign exchange earnings into overseas investments, such as its $5 billion stake in Morgan Stanley and its $3 billion stake in the private equity Blackstone Group. Alaska, Alabama, New Mexico and Wyoming have state sovereign wealth funds; the US government does not.

> "The use of oil, gas and other commodities as political tools and strategic assets, a practice known as resource nationalism, can be an essential part of state capitalism."

Taking advantage of all four tools generally means that a country is exercising state capitalism, though "it's not the tools that count; it's how they're used."

## The State Capitalists

State capitalism reached its current level of resurgence in "four waves." The first began in 1960 with the creation of OPEC. Oil exporters concentrated their power over the oil-importing West, thus massively increasing their wealth. The rising emerging markets of China, Brazil, India, Russia and their ilk in the 1980s and early 1990s formed the second wave. Paradoxically, though these countries took bold steps to privatize their markets, their embrace of full capitalism remained cautious. This economic liberalization, coupled with growing commodity prices, "lifted all boats" in the third wave. The fourth wave came with the 2008 financial meltdown: While it pummeled state capitalists at first, their economies quickly rebounded because of their relative insulation from "toxic bank assets." Free markets' failure to save the world from near economic annihilation provides fodder for those espousing state capitalism as the way forward.

> "Any Russian who doesn't regret the disintegration of the Soviet Union has no heart, but one who wants to revive it has no head." (Vladimir Putin)

State capitalist countries exist worldwide, but the size and scope of Saudi Arabia's, Russia's and China's state economies pose the greatest "fundamental challenge to the future of free markets."

## Saudi Arabia

The Saudi monarchy ensures its political continuity by spending its oil wealth carefully on civic projects that will deter threats to the ruling family. For example, its "grand-scale capitalism" encompasses building "six megacities" in a 150-square-mile area to house, employ and educate some two million people. Recent attempts to open Saudi Arabia's national companies to global competition ended in government rescues. People in a rich society where citizens pay no taxes and firms can rely on government aid have little motivation to cast aside state support in exchange for competitive free-market capitalism.

> "Every country...features both direct government involvement in regulating economic activity and some market exchange that exists beyond the state's reach."

Saudi rulers tightly hold their oil industries. Saudi Aramco, the kingdom's NOC, manages "the world's largest oil company" with top direction from Saudi royals and administrative guidance from externally recruited energy professionals. An SOE – the Saudi Basic Industries Corporation – works, somewhat opaquely, in the petrochemical industry. It withheld promotions and bonuses in 2009, in the wake of oil price drops, raising great internal concern. Saudi national champions include many privately held but family-run businesses, such as the Bin Laden Group. The Saudi Arabian Monetary Agency is both the nation's central bank and its SWF.

### Russia

Russia reeled in the 1990s, whipsawing from the strictures of a Soviet centrally planned economy to laissez-faire markets that enriched greedy oligarchs. Vladimir Putin's ascension to the presidency in 2000 ended the no-holds-barred economy. He retook state control over most of the energy industry and pushed for reforms to protect 42 "'strategic' economic sectors." The government applies its muscle to persuade business owners to follow its objectives. In fact, "public officials have found it's better to control those who run a company than to accept direct and public responsibility for its performance." The government does not interfere in most "consumer-driven sectors," such as "retail, construction, real estate, automotive and wireless telecoms." Russia's state capitalism includes mandating "acceptable" bank interest rates and prohibiting bankers from taking time off until they've "loaned out all the state funds" assigned to them. The state depends on its oil revenues to sustain its political control over the economy.

### China

China relies on the "visible hand" of state control to manage the "invisible hand" of the market. China's move from a rigidly controlled socialist economy to one of capitalist experimentation began in the 1980s. Deng Xiaoping, China's prime proponent of reform, likened the phased changes to "feeling for rocks while crossing a river." Starting with agricultural liberalization and "special economic zones," China unleashed the latent power of its workforce to create a manufacturing and exporting juggernaut.

> "For the next several years, a global economic meltdown widely blamed on free-market capitalism will undermine the arguments of those who believe that intelligently regulated private-sector competition is essential for long-term growth."

For China to remain in power and accommodate its huge population, its rulers must facilitate the creation of "millions of new jobs each year." The country gingerly approaches freeing up some particular aspects of the economy, such as banking. It monitors its energy companies but allows managers a certain amount of discretion in investments and administration.

> "The lesson that many emerging-market governments took from the crisis is that free-market capitalism had ignited a wildfire and that those who had depended on it most had suffered the worst burns."

The 2008-2009 global recession highlighted the weakness of China's reliance on exports as multinational clients drastically cut back their orders, closing numerous small Chinese firms. The government moved quickly to keep order by allocating hundreds of billions of dollars' worth of stimulus spending for job-creating infrastructure investments. China's SOEs used much of the money to swallow private firms, reinforcing the state's grip on its internal economy.

### Responding to the Challenge of State Capitalism

How can free-market participants compete against state capitalism? Private companies should exploit their advantages: greater agility in responding to market conditions and more innovation in marketing than their state-controlled rivals. At the political level, Western leaders should:

- **Advocate for free markets** – US and European politicians should trumpet the long-term returns of truly free enterprise that benefit all people in society.
- **Support open trade –** Western governments must remain committed to "active trade promotion" to continue to work with state-capitalist nations.
- **Consider broader investment** – Legislators should allow long-term business relations to temper their concerns about national security when they weigh foreign investment offers.
- **Admit immigrants** – Free markets and the prosperity they ensure depend on access to the best labor available. "America needs a global talent pool."
- **"Pick the right fights"** – US politicians should limit haranguing China about currency manipulations. China reinvests the revenue it earns in US Treasury securities.
- **"Keep investing in hard power"** – America needs to maintain its global competitive advantage by spending on its "military and economic might."

## About the Author

**Ian Bremmer** is president of Eurasia Group, a political-risk consulting company.