

## The Dark Sides of State-Capitalism as Economic Policy: A Review of Lessons Learned

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### ABSTRACT

State capitalism, characterized by active state ownership and control of enterprises alongside market mechanisms, has emerged as a dominant economic model in the 21st century. While scholarly literature frequently emphasizes state capitalism's capacity for rapid development and strategic resource mobilization, a critical examination reveals fundamental structural weaknesses that undermine long-term economic performance and social welfare. This qualitative literature review synthesizes recent scholarship (2020-2025) to examine the "dark sides" of state capitalism across multiple dimensions. The analysis identifies four interconnected pathologies: (1) efficiency and resource allocation problems stemming from soft budget constraints, capital misallocation, and innovation stagnation; (2) governance failures, including systemic corruption, crony capitalism, and accountability deficits; (3) market distortions through unfair competition and economic sclerosis; and (4) distributional consequences manifesting as wealth concentration and inequality. Evidence from major state-capitalist experiments in China, Russia, Indonesia, and Brazil demonstrates that these problems reflect inherent contradictions between political control and economic efficiency rather than failures of implementation. State capitalism's tendency toward institutional decay, path dependency, and the concentration of political and economic power creates reinforcing negative dynamics

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## INTRODUCTION

State capitalism has emerged as one of the defining economic models of the 21st century, characterized by active state ownership and control of enterprises alongside market mechanisms. This economic system, in which governments function not merely as regulators but also as direct participants in capital accumulation through state-owned enterprises (SOEs), sovereign wealth funds, and strategic national champions, has gained renewed prominence across both emerging and developed economies. In 2023, SOEs comprised 126 of the world's 500 largest companies by revenue and accounted for 12 percent of global market capitalization, underscoring their systemic importance in the contemporary global economy (Ward et al., 2023).

While proponents celebrate state capitalism's capacity to mobilize resources toward strategic developmental objectives and maintain economic stability during crises, a critical examination reveals fundamental structural weaknesses that undermine long-term economic performance and social welfare. The academic discourse has predominantly emphasized the successes of state capitalism in facilitating rapid industrialization and infrastructure development, particularly in China and other East Asian economies. However, this celebratory narrative obscures substantial evidence of inefficiency, corruption, market distortion, and democratic deficit inherent to state-capitalist arrangements (Widjanarko, 2025).

This qualitative literature review addresses a critical gap by systematically examining the "dark sides" of state capitalism as economic policy. Drawing from recent scholarly literature published since 2020, this article synthesizes empirical evidence and theoretical insights regarding the structural contradictions, governance failures, and socioeconomic consequences of state-capitalist models. The analysis focuses on three interrelated dimensions: economic efficiency and resource allocation problems, governance and institutional quality deficits, and distributional inequalities. By examining lessons learned from major state-capitalist experiments, particularly in China, Russia, and emerging economies, this review provides a counterbalance to optimistic assessments and contributes to more realistic policy evaluations.

## LITERATURE REVIEW

### Conceptual Foundations of State Capitalism

State capitalism represents a complex and contested concept in contemporary political economy. Alami and Dixon define it as encompassing "a vast array of practices, policy instruments and vehicles, institutional forms, relations and networks that involve the state to different degrees and at a variety of levels, time frames, and scales". This definitional breadth reflects the heterogeneity of state-capitalist arrangements across national contexts, ranging from China's "market in state" model to Russia's authoritarian variant and emerging Western forms of strategic state intervention (Kinossian & Morgan, 2023).

The theoretical framework of state capitalism challenges conventional dichotomies between state and market. Contemporary scholarship emphasizes that state capitalism should not be understood as the negation of market capitalism but rather as a particular modality of the capitalist state itself. Ward, Aalbers and Grote argue for recognizing "capitalist statism" as the obverse of state capitalism, wherein state powers are mobilized extensively to support market actors' aims within OECD economies. This perspective situates state capitalism within broader patterns of "uneven and combined" capitalist development rather than as a discrete national variant (Alami & Dixon, 2024). Central to state capitalism are "state-capital hybrids" – organizational forms that blur boundaries between public and private spheres, including SOEs, sovereign wealth funds, and state development banks. These entities increasingly emulate private sector practices while pursuing politically determined objectives, creating inherent tensions between commercial viability and state mandates. As Alami observes, contemporary state capitalism involves both "muscular forms of statism" encompassing industrial policy and economic nationalism, alongside the multiplication and geographic expansion of state-capital hybrids (Alami et al., 2021).

### **Theoretical Critiques and Structural Contradictions**

Critical political economy perspectives identify fundamental contradictions embedded within state capitalism. The state faces contradictory imperatives: responding to the forces and disciplines of world-market competition while appeasing domestic constituencies and securing political legitimacy. These tensions generate governance challenges as states attempt to capture, suspend, or spatially displace blockages to capital accumulation while maintaining political control (Alami et al., 2023).

The authoritarian variant of state capitalism, exemplified by Russia and China, reveals particular structural features. Kinossian and Morgan characterize Russian authoritarian state capitalism as a system where "the central state has subjugated the economy, created organisational structures and designed development strategies to serve the interests of the kleptocrat, inverting the conventional meaning of 'state capture'". This configuration centralizes political and economic power to such an extent that alternative centers of power – oligarchs, regional governors, civil society – are eviscerated, eliminating checks and balances (Kinossian & Morgan, 2023).

Zheng and Huang distinguish China's model as "state entrepreneurialism" or "market in state," in which "the fundamental logic of the market is made structurally subordinate to the political imperatives of the state." This differs fundamentally from "state in market" models dominant in Western liberal democracies, where state intervention primarily facilitates private capital accumulation. The Chinese model demonstrates how capital markets can be reconceptualized not as sites for private profit maximization but as instruments through which authorities exercise "statecraft through financial control" to achieve developmental goals (Petry, 2020).

## **Governance Challenges and Institutional Deficits**

State capitalism generates distinctive governance challenges stemming from complex accountability chains. The OECD Guidelines on Corporate Governance of State-Owned Enterprises identify fundamental difficulties arising from accountability involving "a complex chain of agents (management, board, ownership entities, ministries, the government and the legislature), without clearly and easily identifiable, or with remote, principals". Parties within this chain possess inherent conflicts of interest, thereby motivating decisions based on criteria other than the enterprise's best interests and the public welfare (Kurniawan & Viriany, 2023; OECD, 2024).

SOEs suffer from dual governance pathologies. On one hand, they may experience "undue hands-on and politically motivated ownership interference, leading to unclear lines of responsibility". On the other hand, they face insufficient oversight and accountability because ownership entities lack the motivation or capacity to conduct effective monitoring. Critically, SOEs escape two disciplining mechanisms that are essential in private corporations: the threat of takeover and the risk of bankruptcy. This protection from market discipline creates perverse incentives and enables persistent underperformance (Kurniawan & Viriany, 2023; Manuilova, 2016).

Research on SOE governance demonstrates mixed results regarding corporate governance reforms. Kaunda's study of SOEs in least developed economies found that "increased government ownership leads to increased levels of non-compliance with good corporate governance practices" and that "civil servants and politically affiliated directors harm performance". Conversely, reduced government ownership, competent independent boards, enhanced disclosure, and appropriate leverage improve enterprise value. These findings underscore the structural tension between political control and economic performance inherent to state capitalism (Baum et al., 2019; Kaunda & Pelsler, 2023).

## **METHODOLOGY**

This qualitative literature review employs interpretive synthesis to examine the negative dimensions of state capitalism. The methodology differs from systematic literature reviews by prioritizing thematic depth and critical engagement over exhaustive coverage. This approach enables nuanced analysis of complex political-economic phenomena that resist rigid systematization.

The review synthesizes scholarly literature published primarily between 2020 and 2025, ensuring analysis reflects contemporary state capitalism rather than historical variants. Sources include peer-reviewed journal articles, policy documents from international organizations (e.g., the OECD, the World Bank, and the IMF), and authoritative analyses from recognized institutions. Geographic scope encompasses major state-capitalist economies (China, Russia) alongside emerging examples (Indonesia, Brazil, Hungary) and Western adaptations of state-capitalist instruments.

The analytical framework organizes findings across multiple dimensions: (1) economic efficiency and resource allocation, (2) governance and corruption, (3) market distortion and competition, (4) inequality and distribution, (5) political economy and democratic accountability, and (6) systemic and international implications. This multidimensional approach captures the structural contradictions and interconnected pathologies of state capitalism. Thematic coding identified recurring patterns across diverse national contexts, enabling synthesis of generalizable lessons while recognizing contextual variation.

## **RESULTS AND DISCUSSION**

### **Efficiency and Resource Allocation Problems**

#### ***1. Soft Budget Constraints and Underperformance***

A fundamental pathology of state capitalism is the soft budget constraint (SBC) phenomenon affecting SOEs. Cao, Duan, and Uysal's study of Chinese state banks demonstrates that lending quantity increases and quality decreases at month's end, indicating that monthly lending targets lower lending standards. Critically, the decline in quality stems exclusively from SOE lending, which persists even after prior defaults, particularly at month-end when targets must be met. This pattern reveals how SOE lending benefits state bank managers seeking to meet targets while exacerbating SOEs' soft budget constraints (Cao et al., 2023).

The SBC mechanism generates systemic inefficiency through multiple channels. Research using mixed oligopoly models shows that government soft budget constraints and strategic delegation to SOEs lead not only to SOE overcapacity but also to undercapacity in private enterprises. The financing cost coefficient for SOEs is inversely correlated with excess capacity – lower financing costs are associated with greater overcapacity. This misallocation of capital creates opportunity costs, as resources flow to politically favored but economically inefficient SOEs rather than to productive private enterprises (Xiang & Xiang, 2023).

Evidence from the European Bank for Reconstruction and Development confirms that soft budget constraints in state capitalism impose substantial efficiency costs. Bureaucratic incentives favor continued funding for underperforming enterprises over liquidation, as political considerations override economic logic. This "gambling for resurrection" behavior wastes resources while protecting inefficient producers from competitive pressure. Indonesia's experience demonstrates that SOE assets as a share of GDP increased from 43 percent in 2014 to 60 percent in 2020 during the expansion of state capitalism, yet performance concerns regarding capital allocation efficiency persisted (Kim, 2023).

## ***2. Capital Misallocation and Investment Inefficiency***

Political rather than economic criteria driving investment decisions constitute a core weakness of state capitalism. Research on market distortions demonstrates that when prices and resource allocation deviate from equilibrium levels determined by supply and demand, resources fail to be allocated to their most efficient uses. State capitalism systematically distorts these signals by directing capital toward politically strategic sectors regardless of economic returns (Song et al., 2025).

The Indonesian case illustrates these dynamics. Under the Jokowi administration, state capitalism focused on infrastructure expansion, with infrastructure-related SOEs receiving 80 percent of total capital injections between 2015 and 2019. While achieving visible political outcomes, this concentration raised questions about the optimal allocation of resources across the broader economy. State enterprise combined assets increased 12.4 percent annually, from 4,580 trillion rupiah in 2014 to 9,242 trillion rupiah in 2020. Yet, this growth occurred through massive government support, including capital injections, preferential lending from state banks, tax incentives, and reduced dividend ratios (Kim, 2023).

Lombardozi's historical analysis of state capitalism highlights how minimum prices and subsidies create fiscal burdens that disincentivize production diversification. Contemporary global economic governance makes it increasingly difficult to implement fiscal distortions, as multilateral trade agreements and liberalized capital accounts constrain the traditional instruments of state capitalism. This creates a contradiction: as states deploy more resources through state capitalism, the effectiveness of traditional mechanisms diminishes within the globalized neoliberal order (Lombardozi, 2023; Whiteside, 2023).

## ***3. Innovation Stagnation and Technological Deficiency***

State capitalism's impact on innovation presents a crucial dark side. Lin's research on varieties in state capitalism and corporate innovation found that different forms of state ownership significantly impact corporate innovation outcomes. Protected SOE sectors demonstrate reduced R&D investment due to a lack of competitive pressure. Government "picking winners" frequently fails, as documented extensively in the industrial policy literature, leading resources to flow toward politically preferred technologies rather than market-validated innovations (Ciaffi et al., 2024).

Russia's experience with state-sponsored innovation megaprojects exemplifies these failures. The Skolkovo Innovation Centre, intended to replicate Western technology clusters, illustrates how authoritarian state capitalism attempts to modernize its economic base through state direction. However, such top-down innovation strategies face inherent limitations. Without competitive pressure and genuine market selection, state-directed innovation typically yields suboptimal outcomes relative to market-driven innovation ecosystems (Jones, 2023).

Ciaffi's analysis of R&D productivity found that while public innovation spending has positive effects, private R&D spending is critical for productivity growth. State capitalism's crowding out of private investment thus harms the capacity for innovation. The UK's experience demonstrated that reduced government R&D failed to stimulate compensating increases in private R&D, contrary to the "crowding out" theory, suggesting complementarity rather than substitutability between public and private investment in innovation. State capitalism's tendency to centralize resources in SOEs thus potentially undermines both public and private innovation synergies (Acemoglu, 2023; Jones, 2023).

## **Governance, Corruption, and Accountability Deficits**

### ***1. Corruption and Rent-Seeking Mechanisms***

State capitalism creates concentrated economic power that generates opportunities for systematic corruption. Li and colleagues' research on China demonstrates how "inefficient economic institutions create local corruption that raises realized productivity, while generating rents that flow along the party-state hierarchy". This reveals a perverse dynamic where corruption becomes institutionalized within state-capitalist structures, with rents extracted through political channels rather than productive economic activity (W. Li et al., 2022). The crony capitalism variant of state capitalism exemplifies these pathologies. Research on Indonesia's mining industry demonstrates how "close relationships between business actors and political elites create exclusive access to state resources for personal gain, often resulting in economic inequality, social injustice, and environmental degradation". Mining licenses, which are vital to the sector, are granted to politically connected businesses, thereby ensuring preferential allocation of resources. Bangladesh presents another textbook case, in which two-thirds of parliamentarians are businessmen who purchase nominations and contest elections as business investments, with the concept of conflict of interest effectively nonexistent (Ahmed, 2024).

Oxfam's 2024 analysis found that 60 percent of billionaire wealth globally derives from inheritance, monopoly power, or crony connections. In the UK, 37 percent of billionaire wealth stems from cronyism and 15 percent from monopolies—both the highest among G7 countries. This wealth concentration reflects how state capitalism facilitates rent extraction by politically connected elites rather than wealth creation through productive entrepreneurship. Hungary's Strategic Partnership Agreements exemplify this dynamic, providing opaque, favorable entry conditions to politically connected firms while marginalizing market competition (Goldstein, 2023).

### ***2. Crony Capitalism and Political Capture***

State capitalism's tendency toward crony capitalism undermines economic justice and efficiency. Research defines crony capitalism as a system in which business success hinges on close relationships between business figures and government officials rather than on market competitiveness. This generates inefficiencies as resources flow toward connected actors regardless of productivity. Politically affiliated businesses receive preferential contracts,

licenses, subsidies, and access to credit, creating artificial competitive advantages that are detached from economic performance (Baqi, 2024).

The political economy consequences prove severe. Winters explains that in crony capitalist systems, "governments often side with large politically connected corporations, giving them advantages over more efficient or innovative competitors". This selective enforcement of rules benefiting connected actors undermines the rule of law and impersonal institutional frameworks. The breakdown of boundaries between public and private interests creates what Fraenkel termed a "prerogative state"—a discretionary realm serving political will rather than legal-rational governance (Sutrisno & Astuti, 2024).

Hungary's experience with "crony state capitalism" demonstrates the systemic risks it poses. Strategic Partnership Agreements with vague provisions on economic cooperation create favorable conditions for connected multinationals and oligarchs who dominate the construction, tourism, energy, and media industries. This generates perceptions of systemic corruption among small and medium enterprises, undermining trust in market institutions. Research emphasizes these practices "increase levels of economic and political corruption and the retrenchment of markets and democracy"(Goldstein, 2023).

### ***3. Governance Weaknesses and Institutional Deficits***

State capitalism generates profound accountability deficits. Ferry and colleagues' analysis of UK government accounts found significant deficiencies in benevolence, competence, and integrity dimensions of democratic accountability. Government accounts ostensibly supporting democracy and Parliamentary accountability failed to fulfill their stated purposes and were not used internally by the government, despite claims. This mirrors broader patterns in which formal governance structures in state capitalism lack substantive accountability (Ferry et al., 2024).

Research on SOE governance in Oman identified a need to improve the selection and appointment of board directors, as well as the performance orientation of enterprises. Professional management and performance orientation emerged as the most significant contributors to SOE performance. However, achieving these standards proves difficult within political ownership frameworks. SOE governance in Portugal demonstrated that only 52 percent of annual reports were approved by ministries on time, and there were significant limitations in transparency regarding financial flows between SOEs and government entities(CFP, 2023).

The democratic deficit extends beyond individual enterprises to systemic governance. Kinossian and Morgan's analysis of Russian authoritarian state capitalism demonstrates how political centralization in the Kremlin has eviscerated alternative power centers—oligarchs and regional governors—thereby eliminating checks and balances. State-sponsored megaprojects serve not only territorial control but also facilitate the consolidation of authoritarian tendencies through the multi-scalar reconfiguration of state power. This illustrates how state capitalism, particularly in authoritarian contexts, concentrates power in ways fundamentally incompatible with democratic governance(Bull, 2025).

## **Market Distortion and Competitive Dynamics**

### ***1. Unfair Competition and Crowding Out Effects***

State capitalism systematically distorts competitive dynamics by favoring state-backed firms. Research demonstrates that SOEs' soft budget constraints and strategic delegation aggravate not only SOE overcapacity but also private-sector undercapacity. This occurs because subsidized SOE expansion makes financing difficult for private enterprises urgently needing capacity growth. Private firms face higher capital and labor costs when competing against subsidized SOEs, creating what amounts to a "bailout tax" on efficient enterprises (Vahabi, 2025; Wu & Lin, 2022).

The competitive distortion extends across multiple mechanisms. State enterprises receive preferential subsidies, tariff protection, and access to credit at costs significantly lower than those of private firms. This artificial competitive advantage enables SOEs to persist in industries that have long since lost economic usefulness. Indonesia's experience shows that state-capitalist expansion through SOEs reduces the space for private-sector development and entrepreneurship. When government ownership increases, performance declines because multiple conflicting principles lead to ineffective monitoring and control (Chaniago et al., 2023).

Brazil's recent shift toward state capitalism illustrates these dynamics. Measures included increased trade protectionism, an industrial policy based on subsidies and government procurement, substantial funding for the private sector from state-owned financial institutions, and the federal government's push to create "national champions" operating as monopolies or oligopolies. Such firm-specific interventions create systemic risks by selecting individual national champions (rather than supporting sectors broadly), potentially making the wrong choice while denying innovative upstart companies a chance to succeed (Henagan & Sandler, 2025).

### ***2. Stagnation and Economic Sclerosis***

State capitalism's protection of incumbents generates economic rigidity. The persistence of economically obsolete industries reduces overall market dynamism and adaptive capacity. Limited incentives for cost reduction and operational improvement within soft-budget-constrained SOEs create structural inefficiency. These barriers to creative destruction – the market process whereby inefficient producers exit, and resources reallocate to more productive uses – are fundamental to dynamic capitalism (Hidayat, 2025; Mattauch et al., 2022).

Research on state capitalism's economic enhancement acknowledges these concerns, noting that "companies receiving state support may develop dependency relationships that reduce their competitive capabilities" and that "market distortions created by government intervention can crowd out private investment and reduce the overall dynamism of economic systems". The "golden share" arrangements emerging in U.S. state capitalism seek to maximize government influence while minimizing direct financial exposure, yet they risk creating dependencies and distortions (Harcourt, 2023; Hidayat, 2025).

The systemic efficiency costs accumulate over time. Reduced responsiveness to changing market conditions lowers overall system productivity relative to market economies. Increased vulnerability to external shocks results from a rigid structural composition that favors protected sectors. Limited capacity for innovation-driven growth stems from competitive stagnation. Yang's analysis of China's state capitalism notes that, while governance performance improved in specific dimensions of public goods, the investment-led growth model faces sustainability questions as the economy reaches a crossroads(Lin et al., 2021).

## **Inequality and Distributional Consequences**

### ***1. Wealth Concentration and Elite Capture***

State capitalism facilitates the concentration of economic control among state-connected elites. Despite nominal public ownership, actual benefit distribution flows disproportionately to privileged business classes. Oxfam's 2024 analysis found that 60 percent of billionaire wealth globally now derives from inheritance, monopoly power, or crony connections, with cronyism particularly pronounced in state-capitalist contexts. This contradicts narratives that portray state capitalism as serving the public interest; instead, it often functions as an elite wealth-extraction mechanism(Rutherford, 2025).

The vertical structure of state capitalism concentrates gains at elite levels. Research on Indonesia demonstrates how "political elites allocate lucrative contracts, licenses, and resources" through close ties with business actors, thereby creating systems that serve select groups while harming broader populations. Bangladesh's experience shows that members of parliament and ministers' wealth has grown astronomically through business investments facilitated by political positions, while the concept of conflict of interest remains absent(Ahmed, 2024).

Policardo and Ciccone's research on wealth inequality and economic growth found that increased wealth inequality is associated with slowed economic growth. Their analysis emphasizes that the accumulation of non-productive assets and luxury goods drives wealth inequality. State capitalism facilitates such accumulation by providing connected elites access to monopoly rents and state resources rather than requiring productive wealth creation. This generates unjustifiable inequality based on political connections rather than merit or market contribution(Policardo & Sanchez Carrera, 2024).

### ***2. Income Inequality and Opportunity Disparities***

State capitalism creates systematic opportunity disparities. Privileged access to economic opportunities for connected groups reduces upward mobility for non-connected populations. Income differentials emerge between state sectors (with political access) and competitive sectors (facing market pressures). The 2024 Fast Company survey found that income inequality was cited by at least 13 percent of respondents as a potential threat to capitalism, with concerns about the wealth gap reflected across multiple polls. More than half of global income is captured by the top 10 percent of earners, with state-capitalist arrangements often exacerbating these disparities (Paeng & Park, 2025; Zara, 2024).

The extraction dynamic proves particularly pernicious. Research on crony capitalism in Indonesia explains how the system creates "economic opportunities for the majority" that are actually undermined, as connected actors extract wealth from unconnected populations through monopolistic control and political favoritism. This wealth extraction, rather than wealth creation, characterizes the distributional impact of state capitalism. Hungary's Strategic Partnership Agreements demonstrate how oligarchs and entrepreneurs dominating industries "prone to imminent profit creation" extract rents, while small and medium-sized enterprises face marginalization (Borba et al., 2025; Sutrisno & Astuti, 2024).

Sectoral and regional inequality compounds these disparities. State investment concentrates in politically strategic sectors and regions, neglecting less politically favored populations. Uneven development patterns across geographic areas result from political rather than economic allocation criteria. Indonesia's state capitalism under Jokowi focused overwhelmingly on Java-based infrastructure, potentially exacerbating regional disparities despite developmental rhetoric (Lombardozi, 2023; Surya, 2024).

## **Political Economy and Democratic Deficits**

### ***1. Concentration of Political and Economic Power***

State capitalism generates a dangerous concentration of power. The fusion of state bureaucratic and business power concentrates decision-making authority in the state apparatus, limiting constraints on executive power. Russia exemplifies an extreme version: authoritarian state capitalism where "the central state has subjugated the economy, created organisational structures and designed development strategies to serve the interests of the kleptocrat". Political centralization eliminates alternative power centers, thereby eroding checks and balances essential to constrained governance (Cao & Sun, 2025; Kinossian & Morgan, 2023).

Research on authoritarian capitalism characterizes it as a system that favors private property and profit production while restricting access to finance, markets, and political influence to select groups aligned with ruling powers. This creates what Chinese scholars term "party-state capitalism," in which the Communist Party's integration into economic governance enables political control through economic means. The megaproject becomes an instrument of authoritarian consolidation, facilitating a multiscale reconfiguration of state power that serves political stability rather than economic efficiency (Grunberg, 2021; Kryeziu, 2021).

Even democratic contexts face concentration risks. The U.S. experience with emerging state capitalism demonstrates how the normalization of firm-level government intervention outside crisis periods concentrates power in the executive branch. When the president and cabinet members decide the fates of individual companies rather than pursue sector-wide policies, the risks of arbitrary power and corruption multiply. Without institutionalized constraints – congressional authorization, independent oversight, and the application of competition policy – state capitalism threatens the rule of law and property rights that are fundamental to market economies (Henagan & Sandler, 2025).

## **2. Democratic Accountability and Public Interest**

State capitalism undermines democratic accountability through opacity and concentration. Ferry's analysis found that UK government accounts failed to support Parliamentary scrutiny, despite official claims, with MPs unable to hold the government accountable effectively due to inadequate and incompetent accounting practices. This exemplifies how formal democratic structures become hollowed out within state-capitalist arrangements, as complexity and opacity shield actual decision-making from public scrutiny (Ferry et al., 2024).

The distance between nominal public ownership and actual democratic control constitutes a fundamental contradiction. Despite the rhetoric of public interest, state capitalism often serves narrow elite interests. The capture of public narratives by regime propaganda further undermines democratic discourse. Yang's analysis of China notes worsening democratic accountability even as certain governance performance metrics improved, presenting "an uncommon case of improved governance performance" without democratic accountability. This raises critical questions about whether such performance is sustainable in the absence of mechanisms for voice (Yang, 2023).

Research on democratic governance and accountability emphasizes that "accountability mechanisms enhance transparency and legitimacy" but also risk "overburdening governance processes with politicization". State capitalism inverts this concern—rather than excessive accountability, it typically suffers from insufficient accountability as concentrated power evades oversight. The complex chain of agents in SOE governance, without clearly identifiable principals, enables the systematic avoidance of accountability (Bertelli et al., 2025; Ekezie & Balogun, 2025).

### **Systemic and International Implications**

#### **1. Sustainability Challenges and Long-term Viability**

State capitalism faces profound sustainability questions. Alami and colleagues identify fundamental tensions: states face contradictory imperatives to respond to global market competition while appeasing domestic constituencies and securing political legitimacy. These contradictions generate crisis-driven state interventions that may temporarily suspend blockages to accumulation but fail to resolve underlying tensions (Alami et al., 2021; do Vale & Costa, 2024).

The irreversibility problem proves particularly concerning. Once state-capitalist interventions establish path dependencies, phasing out proves politically difficult even when economically beneficial. Brazil's recent experience demonstrates institutional and political constraints on reversing state capitalism, despite recognition of associated inefficiencies and corruption risks. The Trump administration's firm-specific interventions in the U.S. raise similar concerns about the normalization of interventions outside crisis periods, without clear sunset provisions (Alami, 2023; Bonomo, 2024).

Trade-offs between growth and stability, identified in China's model, reflect inherent contradictions. Authoritarian political control enables the persistence of state capitalism but also creates risks of instability when repressive mechanisms weaken. Yang poses the critical question: "Will China disprove the 'autocratic fallacy,' whereby a dominant state setting priorities and making

decisions for a society is sufficient?" Evidence suggests a negative answer – governance performance improvements under state capitalism are conditional and potentially temporary absent democratic accountability and market discipline (X. Li et al., 2015; Wright et al., 2022).

The compatibility question remains unresolved. Can state capitalism function effectively within democratic frameworks, or does it inherently tend toward authoritarianism? Research on Russia and China suggests the latter. As Kinossian and Morgan observe, authoritarian state capitalism in Russia resulted in "no remaining checks and balances in the system" as political centralization became so extensive. The instrumentalization of state capitalism for political control, rather than economic efficiency, undermines its long-term viability, as political imperatives override economic logic (Kinossian & Morgan, 2023; Whiting, 2023).

## **CONCLUSIONS AND RECOMMENDATIONS**

### **Synthesis of Dark Sides**

This qualitative literature review reveals the fundamental structural weaknesses of state capitalism as an economic policy. The evidence synthesized from recent scholarship demonstrates that these weaknesses stem from inherent contradictions between political control and economic efficiency, rather than from mere implementation failures. The multidimensional nature of state capitalism's pathologies – encompassing efficiency losses, governance failures, market distortions, distributional inequalities, and democratic deficits – indicates systemic rather than isolated problems.

The interconnectedness of these dark sides proves particularly significant. Soft budget constraints enable corruption and crony capitalism, further undermining efficiency and crowding out productive private investment. Governance opacity facilitates both corruption and anticompetitive practices while evading democratic accountability. Political concentration through state capitalism both results from and reinforces authoritarianism, creating dynamics that are difficult to reverse. These reinforcing mechanisms amplify adverse effects over time, suggesting that state capitalism's problems worsen rather than self-correct in the absence of fundamental reforms.

### **Lessons Learned from State-Capitalist Experiences**

Major lessons emerge from contemporary state-capitalist experiments. First, SOE performance remains contingent on governance quality, competitive pressure, and hard budget constraints, rather than on ownership structure per se. Reduced government ownership, independent professional boards, transparent disclosure, and genuine accountability improve performance, while increased political control and the appointment of civil servant directors harm it. This suggests that attempts to reform state capitalism while maintaining political control face inherent limitations.

Second, state capitalism tends toward institutional decay rather than improvement in the absence of strong countervailing forces. Crony relationships, once established, prove difficult to eliminate, as connected elites resist reforms that threaten their advantages. The soft budget constraint syndrome persists

because bureaucratic and political incentives favor continuing support for connected enterprises over economically rational liquidation. Path dependencies lock in inefficient arrangements.

Third, trade-offs between political objectives and economic performance prove unavoidable. China's experience demonstrates that growth achievements under state capitalism are accompanied by mounting systemic risks, financial sector vulnerabilities, and sustainability challenges. Russia illustrates how state capitalism, deployed for political centralization, generates economic stagnation and reduces adaptive capacity. Brazil's experience shows how state capitalism generates "capital misallocation, government and market inefficiencies, and corruption" that outweigh claimed benefits.

Fourth, institutional requirements for mitigating the negative effects of state capitalism demand mechanisms of independence and accountability that are often incompatible with political control objectives. The OECD Guidelines emphasize the professionalization of state ownership, the separation of boards from political interference, transparency, and the maintenance of a level playing field with private enterprises. Yet these requirements conflict with the political logic of state capitalism, in which control over SOEs serves regime stability, elite enrichment, and political patronage rather than economic efficiency.

#### **Broader Implications for Economic Policy**

The evidence reviewed suggests limited justification for state capitalism as a general economic policy. While targeted interventions addressing specific market failures may prove beneficial under carefully circumscribed conditions, expansive state capitalism systematically generates problems that outweigh benefits. Alternative approaches emphasizing regulatory frameworks, transparent competitive processes, and private sector-led development with selective state support demonstrate superior outcomes in contexts with adequate governance capacity.

Market-based systems, despite acknowledged imperfections, possess advantages over state capitalism. Decentralized decision-making leverages dispersed knowledge rather than centralizing choices in politically motivated bureaucracies. Competition provides disciplinary mechanisms for efficiency that soft budget constraints systematically undermine. Innovation incentives through profit motive and market selection prove more effective than state direction. Reduced opportunities for corruption in transparent, competitive frameworks contrast with state capitalism's systematic rent-seeking pathologies.

Future research should examine the conditions under which existing state-capitalist systems might transition toward more market-oriented models, as well as mechanisms for accountability in democratic contexts that retain state ownership. Longitudinal research tracking the long-term performance trajectories of SOEs would illuminate whether governance reforms suffice or ownership transitions are necessary. A political economy analysis of reform resistance and path dependency could clarify the obstacles to improving state-capitalist arrangements. Comparative institutional analysis across contexts may identify specific conditions that enable state capitalism to avoid typical pathologies, if such conditions exist.

### **Final Remarks**

State capitalism as an economic policy contains fundamental systemic weaknesses stemming from inherent contradictions between political control and economic efficiency. Evidence from multiple case studies—China, Russia, Indonesia, Brazil, and Hungary—reveals systemic rather than isolated problems. Short-term developmental gains often mask long-term sustainability issues, with accumulating inefficiencies, mounting corruption, increasing inequality, and eroding institutional quality.

Academic and policy communities should move beyond celebratory narratives toward a critical, realistic assessment. Recognition of legitimate criticisms and documented failures enables evidence-based policy rather than ideological commitment. The path forward requires selective, limited, time-bound state intervention based on rigorous market failure analysis rather than expansive state capitalism. Strengthening governance, transparency, and accountability mechanisms proves essential where state ownership persists. However, given the structural contradictions identified, a preference for market-based solutions with targeted corrections offers more promising avenues for development than the consolidation of state capitalism.

Sustainable economic development requires more than state capitalism offers. The concentration of political and economic power, systematic inefficiency, entrenched corruption, distributional injustice, and democratic deficits documented in this review constitute not aberrations but logical consequences of the structural features of state capitalism. Policymakers and citizens in both emerging and developed economies should approach state-capitalist arrangements with appropriate skepticism, demanding rigorous evidence of benefits while remaining alert to inherent dark sides.

### **FURTHER STUDY**

This research still has limitations so that further research is needed on the topic of *The Dark Sides of State-Capitalism as Economic Policy: A Review of Lessons Learned* to perfect this research and increase insight for readers and writers.

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