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The Corporatist State and Its Investment Implications

From personal experience, most of us understand that humans often focus on issues in the here and now rather than big, abstract trends that are hard to understand or categorize. We tend to get caught up in the stresses of everyday life. Perhaps we get up in arms about the near-term movement in the stock or bond market, rather than the geopolitical and economic forces that underlie their behavior. As macro analysts focused on the global political and economic environment and how it can affect asset prices, one thing we here at Confluence are paying attention to is the changing relationship between the government, business, and everyday individuals. As we discuss in this report, we believe the system of political economy is shifting in the United States and many other countries, moving away from the pluralistic norms that prevailed for decades. We think the trend is toward a "corporatist" state that will have big implications for investment performance and strategy going forward.

The Old Liberal Pluralist State
Before explaining why we think corporatism is taking hold in the US and beyond and how it will affect investing, we first must describe the system it's replacing. That system is best termed "liberal pluralism," and it is the only political economy that most of us have ever lived under. Let us note here that liberal in this sense describes a type of free society and is not the same as political liberalism.

Liberal pluralism began to dominate Western civilization only about 250 years ago with the American and French revolutions. In its long mature phase straddling the 20th century, Western liberal pluralism was a democratic political system that subjected state power to the vote of individuals, protected individual rights, and espoused the benefits of private property and free markets. Organized political parties developed in order to protect the interests of different classes of individuals, often along a political spectrum running from relatively conservative capital owners trying to protect or grow their wealth to less satisfied workers seeking to reduce the precariousness of their lives and grab a greater share of national income.

In liberal pluralism, electoral competition between the various political parties in a democratic context means that control of state power regularly shifts between capital owners and labor. For example, the election of President Franklin D. Roosevelt in 1932 ushered in a decades-long period in which Democrats dominated the US government and generally promoted working-class interests. However, control of Congress and the White House still alternates between Democrats and Republicans. The election of President Ronald Reagan in 1980 ushered in a long period in which Republicans have dominated government and have promoted the interests of the business class, but that hasn't prevented periods in which the Democrats sometimes have taken control of the presidency or at least one chamber of Congress.

What causes the regular power shifts under liberal pluralism? In simplistic terms, when one party or coalition takes power from its rival, it often begins to implement policy changes that are widely agreed on and supported. Over time, however, the incumbent party often stumbles as it faces the hard complexities of governing in real life. Electoral competition may discipline the incumbent party from pursuing unpopular policies, but that party can still make mistakes. In any case, growing popular dissatisfaction with the incumbent and the rival power's own housecleaning allow it to eventually regain power, starting the cycle over again.

Of course, the power shifts under liberal pluralism can complicate investment strategy. As one party takes control from the other, investors often face revisions in tax law, fiscal and monetary policy, trade policy, antitrust regulation, environmental regulation, and the like. Indeed, our analysis shows that in the US, asset returns are generally highest in periods when opposite parties control the White House and Congress, since that situation limits the ability of either major party to push through dramatic policy changes.

The Evolving Corporatist State

In contrast with the liberal pluralist state described above, we define a corporatist state as one in which the government co-opts ***both*** the main political-economic interest groups — capital and labor — at the same time and in a relatively formal, continued way. Such a structure usually requires the government executive to have an unusually high degree of political power. Being in a strong political position allows the executive to dole out political or economic benefits or mete out punishments as required to keep both business interests and working-class interests in line.

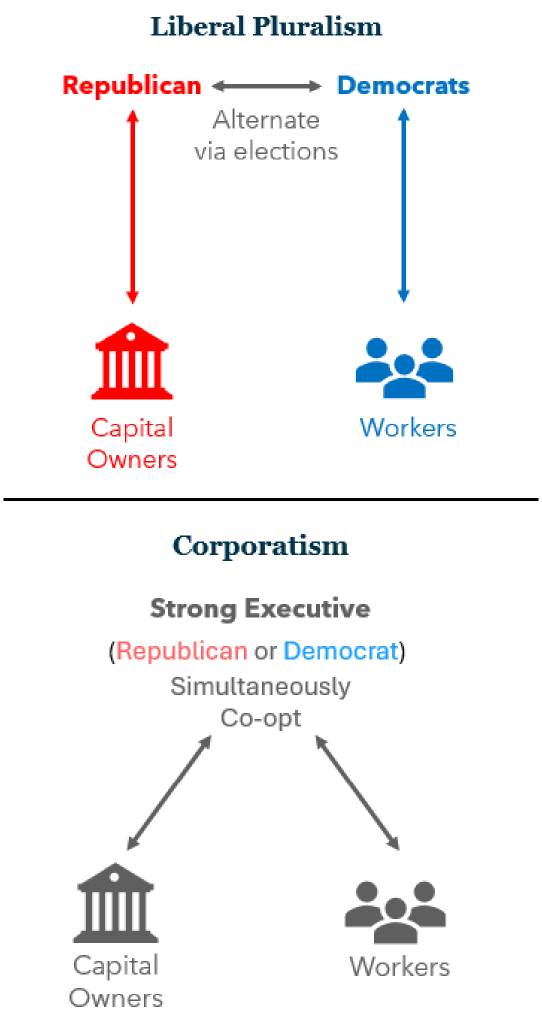
Why might a strong executive want to replace liberal pluralism with corporatism? The executive's prime goal would likely be stability and greater capacity to achieve their goals. If the executive has the insight to understand the interests of both capital and labor, and if they can deftly hand out benefits and punishments to keep both groups happy, the leader might be in a good position to trade political or economic benefits for political support from both, eliminating the risk that either capital or labor interests would vote against the government at the next election.

Indeed, corporatist states in the past have led to entrenched power with long periods of political stability. For example, Mexico under the Institutional Revolutionary Party was essentially a corporatist state, with the party (rather than individual leaders) co-opting both private and state-owned enterprises and labor unions. The PRI's corporatist state survived for 71 years, from 1929 to 2000. Other well-known corporatist states that exhibited staying power included Argentina under President Juan Perón and Spain under President Francisco Franco. Italy under Mussolini and Germany under the Nazis were examples of unusually extremist, violent corporatist states.

Finally, it's important to note at least one key difference between corporatism as we define it here and socialism or communism. Marxist thought essentially teaches that capital owners will always act to the detriment of workers, but that a process called the "dialectic of history" will eventually result in the state taking ownership of the "means of production" from the capital owners and using those resources in the interests of the workers.

Leninists believe this process should be accelerated by establishing a revolutionary Communist Party that seizes the means of production and expropriates capital owners, by force if necessary. In contrast, the corporatist state allows capital owners to retain ownership of their businesses and continue making profits, so long as the capital owners support the government politically. The state takes the same approach to labor, often protecting unions, so long as they support the government.

Figure 1



Today's Corporatism

We now turn to an in-depth examination of modern corporatism, focusing on how it appears to be developing in the US.

Consistent with our analysis above, we believe that the key condition allowing for corporatism to begin in the US is that President Trump has garnered such a high degree of political power. Whether the president's unusual room to maneuver reflects his political skill, will to power, direct style, or some other factor, we think he has been especially methodical and successful in co-opting both capital owners and a key segment of the working class in the following ways (see Table 1, next page).

The Business Sector. To ensure the political and financial support of the business sector, the developing corporatist state in the US is pursuing fairly traditional pro-business policies, such as reduced regulation, tax cuts, and protectionist trade policies. This is no surprise, given that President Trump's Republican Party is the US's dominant conservative, right-wing party and has long espoused pro-business, pro-growth policies with a strong commitment to private property rights and free markets. What makes the administration's corporatism unique is its particular sectoral bent. The administration has focused on interventions in the economy to help specific economic sectors and to secure political and financial benefits from them. This tendency has become so pronounced that we titled our outlook for this year "The 2026 Outlook: Implications of the New Techno-Industrial State." Specifically, the administration is focusing on its ties to the following sectors:

- *Technology* — The administration's tax, budget, and regulatory policies have been geared to benefit the advanced technology sector in a traditional way, but the White House has gone far beyond traditional US practice by aggressively wielding its trade policies to benefit US tech firms. For example, it has threatened retaliatory tariffs against the European Union if it doesn't dismantle a digital services tax that disproportionately affects US tech giants. The administration has also struck deals to take ownership stakes in key tech firms, such as Intel.

- The administration isn't trying to seize or fully nationalize the means of production as Marxist-Leninist Communists would. However, by taking stakes in private US tech companies, providing them with guaranteed markets, and enforcing price floors for them, the administration is overriding the traditional US reluctance to have the government distort market operations.
- In return, major tech leaders have swung their political support strongly toward the administration, not only rhetorically but also in terms of financial contributions.

- *Critical Minerals* — After China demonstrated its ability to essentially cut the West off from its supply of rare earths and other critical minerals in response to the administration's trade war in 2025, the federal government has similarly complemented its general pro-business policies with investments and ownership stakes in key critical mineral firms. As with its technology investments, it has also offered those firms financially beneficial contract terms, such as price floors and guaranteed sales.
- *Defense* — Finally, the White House has taken a more ambiguous approach to defense contractors. While the administration has proposed huge new increases in the defense budget, it has also more explicitly put financial pressures on the companies. For example, the president has demanded better pricing and faster weapons deliveries, even as he threatened to force defense firms to reduce their dividend payments and stock repurchases. Those demands may be painful for the defense sector, but on balance, we suspect the companies will continue to express their support for the administration in return for its proposed defense spending hikes.

Table 1

Liberal Pluralism vs. Corporatism

Dimension	Liberal Pluralism	Corporatism
Political Competition	Power alternates regularly between parties and coalitions	Dominant coalition remains in power longer
Source of Legitimacy	Electoral competition among competing interests	Executive balances and coopts major interests simultaneously
Relationship with Business	Arms-length, rules-based	Strategic partnership with favored firms/sectors
Relationship with Labor	Labor represented through parties and unions	Labor receives targeted economic, social, or cultural benefits
Role of Government	Referee of market competition	Active participant in allocating resources
Industrial Policy	Limited and broad-based	Targeted toward strategic sectors
Regulation	Generally consistent across industries	Differentiated by political importance
Trade Policy	Primarily efficiency-oriented	Strategic and national-interest oriented
Technology Sector	Subject to standard competition policy	Potential national champion status
Critical Minerals	Market-led investment	Subsidies, guarantees, strategic investment
Defense Industry	Subject to procurement process	Strategic partner but under closer government oversight
Capital Allocation	Driven primarily by private markets	Influenced by government priorities
Macro Stability	Subject to normal business cycles	Greater policy effort to smooth cycles
Primary Risk	Legislative gridlock	Policy error by concentrated leadership

The Working Class. The policies above appear to have helped solidify political support for the administration from the business sector, but the president has also masterfully built his support among labor, or, specifically, among a large sector of the working class. The difference is that the policies benefiting the president's working-class base haven't been primarily economic.

- Many of these individuals appreciate the administration's vow to protect Medicare and Social Security, and many did benefit to some extent from the administration's tax cuts. Others probably also hope the president's protectionist trade policies will eventually lead to US reindustrialization, while his pro-growth economic policies create better job opportunities in the near term. However, many (such as farmers) have suffered from administration policies like the trade war, which invited retaliatory tariffs and other trade barriers against US agricultural goods.
- More importantly, we think a large subset of the working class admires the administration's social and cultural policies. We suspect the core of the president's working-class base especially appreciates the administration's effort to curb both illegal and legal immigration. We think many also support its effort to roll back diversity, equality, and inclusion policies in government, academia, and business. In sum, even if these voters haven't seen much economic benefit from the president's policies so far, we believe many are happy with the social and cultural benefits that respect their concerns and buttress their status in US society.

Investment Implications

As noted above, one goal for politicians trying to build corporatism is to solidify their political position. That's another way to say that they're seeking political stability, which in theory could translate into a stable economic and investment environment. However, given that a corporatist system implies a strong executive with extraordinary room to maneuver, much would depend on the executive's temperament. If the executive is a mercurial personality who shifts often and/or dramatically between doling out benefits and meting out punishments to capital and labor, or to sectors or subsectors of those groups, the investment environment might actually become or feel unstable and unpredictable for investors.

Nevertheless, as the strong leader in a corporatist system gives out benefits or issues punishments to capital and labor, or to specific sectors within them, the overall macroeconomy could become more stable. Indeed, that could be especially likely now that governments around the world have developed and embraced new tools to manage the economy. For example, the Federal Reserve developed a range of tools to buy up assets during the Great Financial Crisis and the coronavirus pandemic. Congress and the executive branch also developed or greatly expanded powerful fiscal policy tools, including direct payments to businesses and individuals. As a result, the government can now ease or short-circuit the business cycle. In fact, many economic and market indicators reflect the reduced likelihood of recession. In Figure 2 (next page), for example, the grey, vertical recession bars are clearly much more frequent before the GFC. Figure 3, next page, shows how low the spread on Baarated corporate bond yields has become compared with its 20-year average.

Figure 2

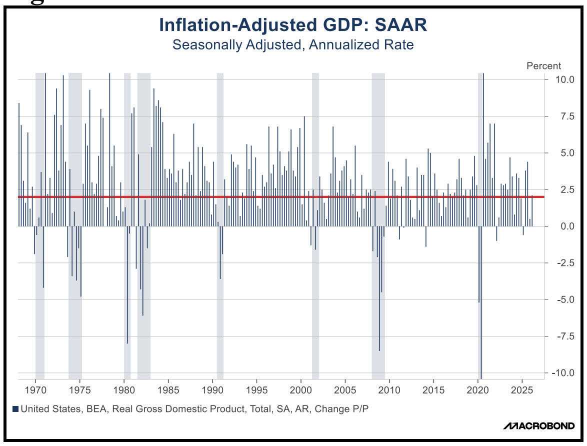
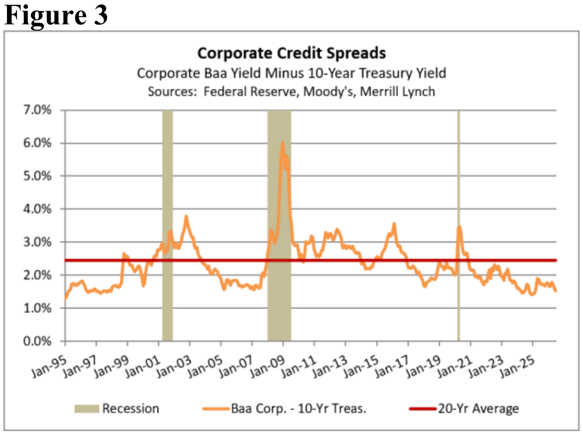


Figure 3



Assuming that the US and other Western countries continue to move toward a more corporatist political-economic system under the leadership of strong, right-wing populist leaders, we think investment strategy might require a keen analysis of which specific sectors of business or labor the government favors.

Taking advantage of the government's stance would also require a willingness to buy assets related to those sectors, while avoiding sectors that are politically at odds with the government. In the US today, this would imply keeping fairly high exposure to the stocks of technology and critical minerals companies favored by the administration. If populist parties take control of countries in Europe and move toward corporatist systems, they may co-opt and favor a completely different set of sectors, so investment strategy might require a different set of overweights there.

In any case, investment strategy going forward must recognize a higher degree of government control over the economy and markets than would have been accepted during the Era of Globalization from 1991 until about 2021. Now that governments have more tools to manage the business cycle, that involvement in the economy could continue to smooth the business cycle and support today's high asset valuations.

However, at some point, government leaders could still make a mistake and could actively work to punish particular sectors of the economy that don't give them enough political support. Investment strategy will therefore put a high premium on identifying and investing in favored sectors while avoiding those that are out of favor.

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Confluence Investment Management LLC

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