The state and economic development: what role, what risks?

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Phase 1. Post-war development policy focus on
   i) increasing investment and infrastructure,
   ii) creating new capitalists by encouraging rapid asset
       transfers (the modernization thesis),
   iii) protection of emerging capitalists using subsidies and
tariffs to assist catching-up (infant industry protection)

Politics and institutions underplayed:
Authoritarian regimes tolerated on the grounds that
they allowed high investment rates, accelerated the
creation of new capitalists and kept communists at bay
(variants of the modernization thesis)

A few dramatic successes
in East Asia (such as
Taiwan and South Korea)
but many more disastrous
failures in Asia and Africa
with authoritarian regimes
creating unproductive
elites and infant industries
that refused to mature

Growth-enhancing strategies but often without appropriate
governance capacities
Phase 2. 1980s development policy focus on neo-liberal policies to cut back subsidies across the board to reduce inflation as a precondition for market-led growth (structural adjustment).

Although inflation was reduced, very poor results for growth, poverty reduction, and rent seeking, particularly in Africa and other poorly performing countries where the main effect was often economic recession.

Political reform expected to follow from the economic reforms: ‘Right-sizing’ the state expected to reduce rent seeking and corruption (neo-liberal ‘new political economy’ and rent-seeking theories).

Market-enhancing strategies with no real concern for governance.
Phase 3. 1990s economic policy remains focussed on market-led economic growth (based on already existing comparative advantage) (deepening liberalization)

Political and institutional policy to focus state capacities on market-promoting governance: reforms of property rights, rule of law, anti-corruption, and democratization, combined with pro-poor service delivery (good governance reforms and the service-delivery state)

Some developing countries achieve moderate growth through low-technology exports but many perform poorly. The most successful developers like China or Vietnam do not conform to many characteristics of the good governance and service-delivery models

Market-enhancing strategies supplemented with market-enhancing governance
Market-Enhancing Governance: Composite Property Rights Index and Growth (using Knack-IRIS data) 1990-2003

IRIS 'Property Rights' Index 1990 (ranges from 0 to 50)

Growth Rate of Per Capita GDP 1990-2003

Diverging Developing Countries
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Advanced Countries
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Advanced Countries
Converging Developing Countries
Diverging Developing Countries

IRIS 'Property Rights' Index 1990 (ranges from 0 to 50)
Governance and Growth

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Advanced Countries ▲ Converging Developing Countries □ Diverging Developing Countries

Growth Rate of Per Capita GDP 1990-2003

Advanced Countries ▲ Converging Developing Countries □ Diverging Developing Countries
State Capabilities and Reform Priorities

1. Diverging Developing Countries
   - Reforms that transform Failing States into Developmental States

2. Converging Developing Countries
   - Reforms that improve governance in successful transformation economies
   - Regression Line

3. Advanced Capitalist Countries
   - Reforms suggested by Good Governance and related frameworks (but very little historical evidence of this trajectory)

Governance Characteristics
(Democracy, Corruption, Stability of Property Rights)
Source: Khan (2004)
Three types of growth strategies

**SUSTAINABLE CATCHING-UP STRATEGIES**

Strategies of accelerated learning and catching up *with* effective political capacities of rent-management to ensure rents are time-bound and withdrawn from non-performers

Sustainable growth driven by high rates of accumulation *and* sustained productivity growth

**UNSUSTAINABLE CATCHING-UP STRATEGIES**

Strategies of accelerated learning and catching up *without* effective political capacities of rent-management

Growth initially driven by high rates of accumulation but eventually unsustainable

**MARKET-LED STRATEGIES**

Strategies of integrating into global markets using already existing technical competence

High growth in countries with niches of international competitiveness but limited to a few sectors and typically with low productivity growth

Low growth in countries with low competitiveness across the board
Governance and growth

Converging countries did not have good governance.

Successful growth strategies have been based either on sustainable catching-up strategies or on market-driven growth based on existing comparative advantage.

The first real question is whether good governance reforms made market-driven growth more likely: case studies suggest answer is NO + structural impediments to achieving GG.

The second question is whether market-driven growth is sustainable: no clear evidence yet but theoretical doubts.

Final question is what allowed some catching-up strategies to be sustainable.
Stabilizing and protecting property rights is costly and assumes that most assets are already productive: managing non-market transfers is critical.

Political stabilization is expensive and often requires off-budget resource allocations: political structures that allow minimum stability are critical.

Catching up requires learning-by-doing. Managing this reasonably efficiently has large payoffs.
Contestable property rights are the norm

Collapsing Pre-Capitalist Economic Sectors → Primitive Accumulation

Resources Captured by Unproductive Groups:
- **Economic Collapse**

Resources Captured by Emerging Capitalists with Effective Disciplining:
- **Emerging Capitalism**
Politics is about patron-client redistributions

- Poor Economy (Largely Pre-Capitalist)
- Severely limited Fiscal Resources
- Political Stabilization using Off-Budget Resources and Patron-Client Networks
  - PoliticallyDriven Corruption to Raise Off-Budget Resources
  - Sufficient Political Stability for Capitalist Accumulation to Continue
  - Political Collapse and End of Accumulation
But catching-up strategies do not always work.
### The Political Economy of State Capabilities

<table>
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<tr>
<th>Industrial Policy Institutions (Rent Management Strategy)</th>
<th>Corresponding Political Configuration</th>
<th>Economic Outcome</th>
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<td><strong>South Korea</strong> 1960s</td>
<td>Targeted Learning Rents</td>
<td>Limited political power of intermediate class factions to protect inefficient capitalists</td>
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<td><strong>Malaysia 1980s 1990s</strong></td>
<td>Public sector and MNC-led technology acquisition</td>
<td>Powerful intermediate classes but centrally organized after 1980</td>
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<td><strong>Indian subcontinent 1960s 1970s</strong></td>
<td>Targeted learning Rents, Public sector technology acquisition</td>
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<td>Indian subcontinent 1980s 1990s</td>
<td>Liberalization and slow withdrawal of subsidies for learning.</td>
<td>Powerful and fragmented intermediate classes remain growing political fragmentation</td>
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<td>Latin America 1950s to 1970s</td>
<td>Selective tariffs, selective credit policy</td>
<td>“Corporatist” alliances between industrialists, intermediate classes and urban working class</td>
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<td>Latin America 1980s onwards</td>
<td>Rapid liberalization</td>
<td>Widespread breakdown of corporatist alliances</td>
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Research and Policy Agenda

The goals of good governance are desirable in themselves but as a reform agenda for the state it asks limited/wrong questions and gives the wrong answers to these questions.

- The starting point must be good analysis of how patron-client networks in particular countries have allowed some types of value enhancing economic transformations and prevented other types.
- Reform has to identify institutional and capacity changes to allow faster and more effective technological catching up, better and more effective political stabilization etc.
- In many cases this will open up national debates and dialogue on the organization of political power (which is different from the debate about democratization).