

FEATURE ESSAY

Which Comes First in Development—State Capacity or Economic Growth?

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Does state capacity lead to markets or do markets lead to state capacity? This is a fundamental—and yet still poorly understood—question in political economy. We all agree that late-developing economies require state capacity in order to promote markets. State capacity encompasses the capacity to formulate and implement coherent economic policies, collect taxes, redistribute resources, and obtain social compliance with state agendas. Yet most of us will agree that the acquisition of state capacity is also dependent on the level of economic wealth. Although poor countries would like to achieve state capacity, they are severely constrained when it comes to building effective bureaucracies, eradicating petty corruption, enforcing law and order, gathering information, and so forth.

Despite the obvious reality that state capacity and economic growth are inextricably intertwined, their endogenous relationship has been largely neglected. Instead, dominant theories posit that either effective governance or growth comes first in development. Aligned with modernization theory, some believe that wealth precedes state capacity, and good institutions like democratic mechanisms of accountability will blossom once societies become rich (Inglehart & Welzel, 2005). Others, in particular the World Bank and Western policy-makers, assert that late developers must first establish the norms of good governance and rule of law (whatever it means) before they are capable of achieving growth (Kaufmann, Kraay, & Zoido-Lobaton, 1999). Following a path-dependent logic, a third school traces the origins of state capacity to colonial legacies (Acemoglu & Robinson, 2012; Kohli, 2004). This school argues that nations that currently boast stronger state capacity than others enjoyed better histories.

A core limitation of the existing schools of thought is that each captures

only one slice of the grand, dynamic picture of development. Indeed, increased levels of wealth will empower political and institutional change. Additionally, modern state capacities are necessary for capitalist markets to flourish. And yes, history may cast a long shadow on the present. However, those who argue that markets lead to state capacity do not specify the origins of markets. Those who point the causal arrow in the opposite direction cannot explain how state capacities emerge. Finally, those who spotlight history verge on determinism and struggle to explain instances when societies radically break from their past and forge new paths—as vividly illustrated by China’s experience during the reform era.

In my forthcoming book, *How China Escaped the Poverty Trap*, to be published by Cornell University Press (Cornell Studies in Political Economy), I propose a new way of thinking about the sources and dynamics of development—one that views development as a fundamentally *coevolutionary* process. States and markets necessarily adapt to each other and coevolve. In different places and at different points in time, changes in market conditions push state reforms and vice versa in a coevolutionary causal chain. Once we place the coevolutionary relationship between state and market at the heart of our analysis, two new and challenging questions are raised: How exactly does the economy and governance coevolve? What particular environmental features and strategies enable poor and backward societies to coevolve—in other words, to grow markets and to modernize governance simultaneously?

China’s great transformation presents an important and particularly illuminating case to explore these central questions. As China specialists will readily attest, China did not “get governance right” in one bold sweep before

achieving spectacular capitalist growth. Nor did Chinese reformers wait until there were sufficient financial resources before internally remolding the administration. Many observers have described the Chinese state as remarkably adaptive and entrepreneurial. However, such abundant descriptions of adaptability beg the question of why China appears to be exceptionally adaptive and why adaptation has worked so well, at least thus far. After all, the norm, especially in the developing world, is that governments either refuse or are unable to adapt.

My book pursues two connected objectives. The first is to map the coevolution of the Chinese economy and its bureaucracy at the national and sub-national levels over three decades of reforms. State capacity encompasses multiple dimensions, and among them, I choose to focus on bureaucratic capacity for a compelling reason. Capitalist markets can thrive in both authoritarian and democratic regimes, but they certainly cannot flourish in the presence of a patrimonial, corrupt bureaucracy that arbitrarily preys on business and that is incapable of executing state policies (Evans, 1995). By systematically mapping the changes that unfolded in the economy and the bureaucracy in different parts of China over the past decades, this exercise reveals new insights that challenge conventional wisdoms. Two insights are highlighted below.

1. The package of institutions—both economic and bureaucratic—that propel early growth stages is qualitatively different from the standard package of good institutions that support mature capitalist markets. Acemoglu and Robinson are correct to argue that non-extractive and inclusive institutions, such as the formal protection of property

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rights and a level economic playing field, are conducive to development. But this is only the case during late growth stages. Whether in China, early modern Europe, or the United States, the take-off of development was propelled by institutions that we normally regard as backward or corrupt.

2. Political elites, whether at the national or sub-national levels, do not in fact have fixed preferences that we know a priori and from which we can infer predictable decisions. China's national leaders often do not know what specific outcomes they envision or prefer, choosing instead to issue deliberately vague directives to local agents. Meanwhile, in the localities, the leaders' particular preferences for types of economic policies and bureaucratic practices evolve over time in response to changing market conditions. The goals and preferences of elites are often altered by the unexpected consequences of their prior decisions.

The coevolutionary paths of development revealed in my study trigger a deeper question: What are the environmental features in China that enabled a coevolutionary process of radical change? How and by whom were these features created? I argue that China achieved its extraordinary makeover through an adaptive approach that I call *directed improvisation*. This system is distinct from "plan-ideology" under Mao and "plan-rationality" in the East Asian developmental states, labels employed by Chalmers Johnson (1982) to characterize the two contrasting political economies. In these archetypes, "plan" refers to the enactment of specific policies or institutions believed to bring about national prosperity. In both instances, the state assumes it knows what will work.

Under directed improvisation, the national government does not engineer

specific planned outcomes, but instead it establishes a platform that empowers local agents to improvise solutions and to implement central goals according to changing and diverse circumstances. As suggested by complexity frameworks (Axelrod & Cohen, 1999), the creation of an effective platform involves addressing three generic problems of adaptation: how to influence the range of possible solutions (variation); how to clearly define and reward success among agents (selection); and how to turn inequality of resources across units into a collective advantage (niche creation). As I argue, the directed improvisation approach has not only enabled China to escape the poverty trap, but it has also produced a distinctively broad, bold, and uneven pattern of transformation, with consequences that will reverberate well into the twenty-first century.

In combination, the insights in my book suggest an urgent need to rethink some core assumptions that have guided both development theories and practices. For decades, building state capacity, or "getting governance right," has meant replicating particular institutional forms—primarily those found in capitalist democracies—that are believed to pave the way for markets: Weberian bureaucracies, impartial courts, formal protection of property rights, and so on. In contrast, my study calls attention to the creation of meta-institutions that foster adaptive processes, which in turn can produce diverse and changing institutional forms, whose exact shape cannot be fully predicted in advance.

More specifically, my study underscores our gap in knowledge about the variety of institutions that can potentially kick-start development. These are qualitatively different from those institutions known to sustain development. Almost invariably, the former set of institutions builds on pre-existing informal and traditional practices, such as personal connections, clan-based ties, and religion. However, when these practices are

dismissed as either backward or corrupt, we are unable to appreciate—much less activate—their developmental potential. In other words, how we interpret what people do is not a frivolous, low-stakes exercise of subjective judgment. Rather, it has significant theoretical and policy implications.

The lessons of China's escape from poverty have far-reaching relevance for other developing countries. They inform pressing challenges facing the United States to lift poor and weak states, such as Afghanistan, out of poverty traps. By recognizing the normative assumptions implicit in conventional wisdom and then setting these assumptions aside and by embracing development as a dynamic rather than as a linear process, there is much promise to innovate new and localized methods of promoting development.

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