



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

Mushtaq H. Khan,  
Department of Economics, SOAS

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

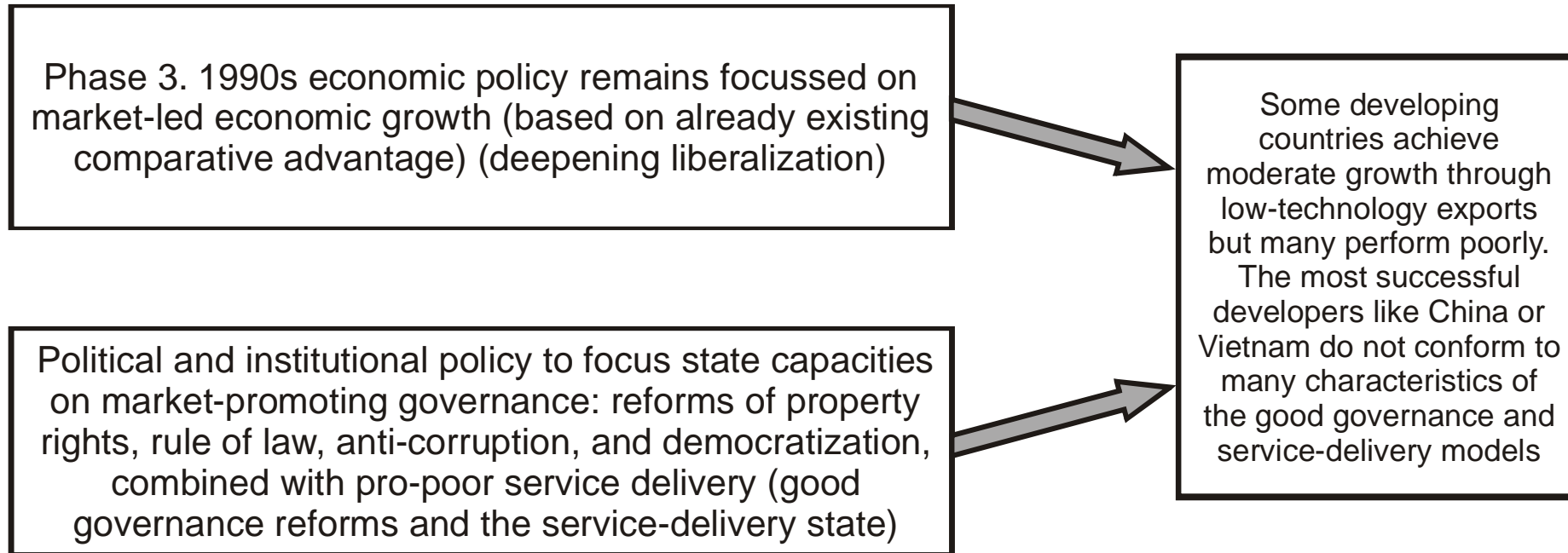
Growth-enhancing strategies but often without appropriate governance capacities

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 )

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)

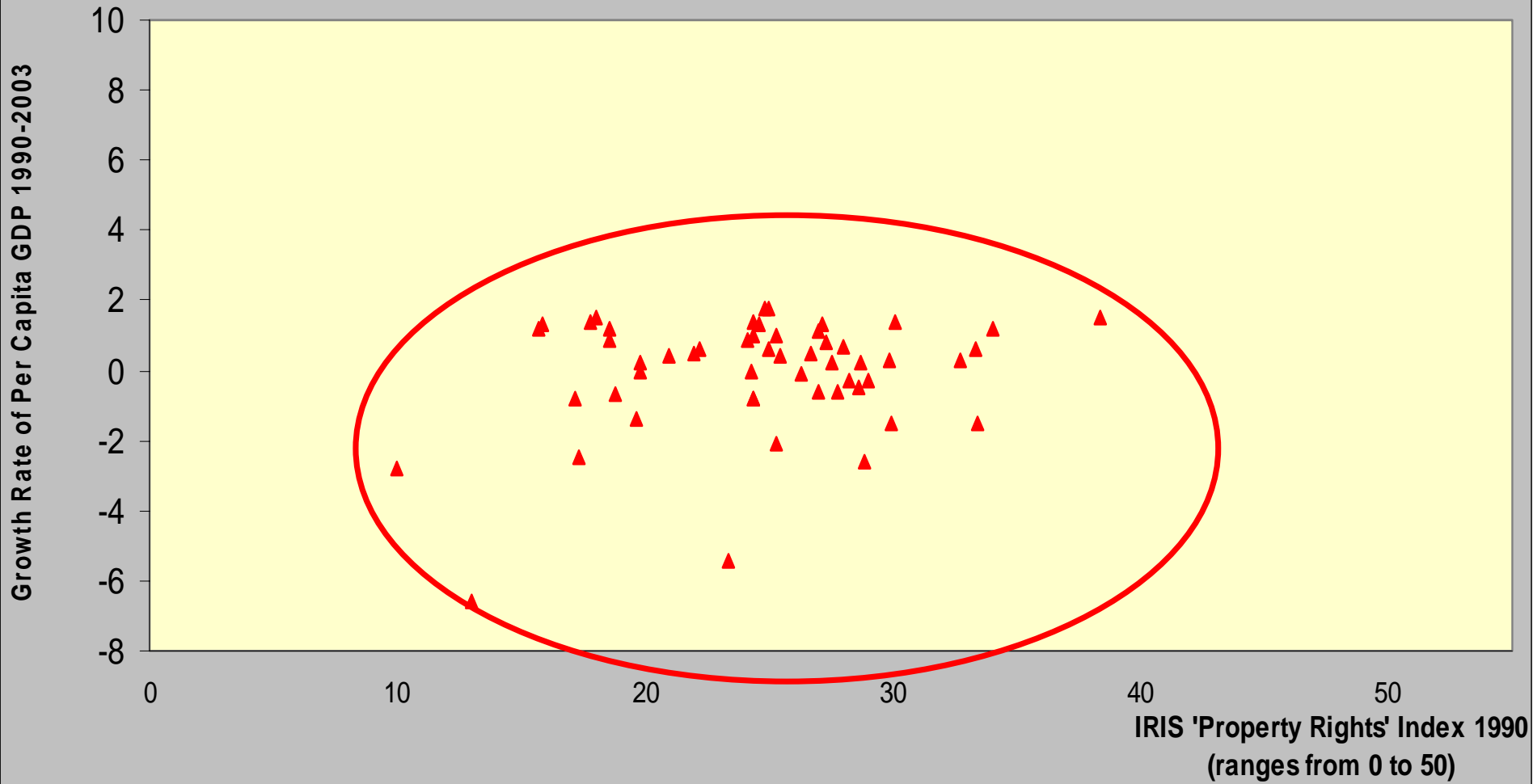
Although inflation was reduced, very poor results for growth, poverty reduction, and rent seeking, particularly in Africa and other poorly performing countries where the main effect was often economic recession

Market-enhancing strategies with no real concern for governance



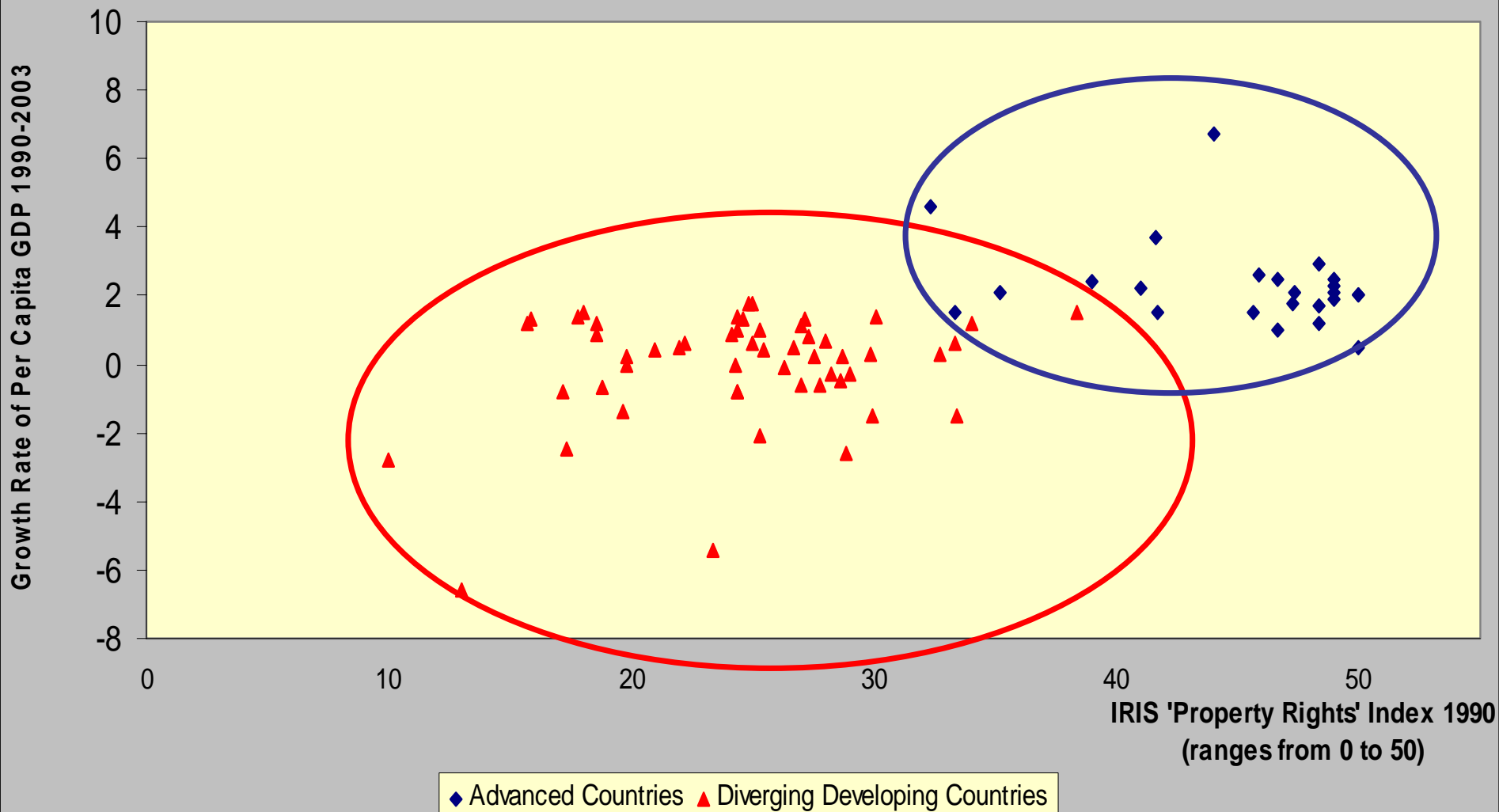
Market-enhancing strategies supplemented with market-enhancing governance

## Market-Enhancing Governance: Composite Property Rights Index and Growth (using Knack- IRIS data) 1990-2003

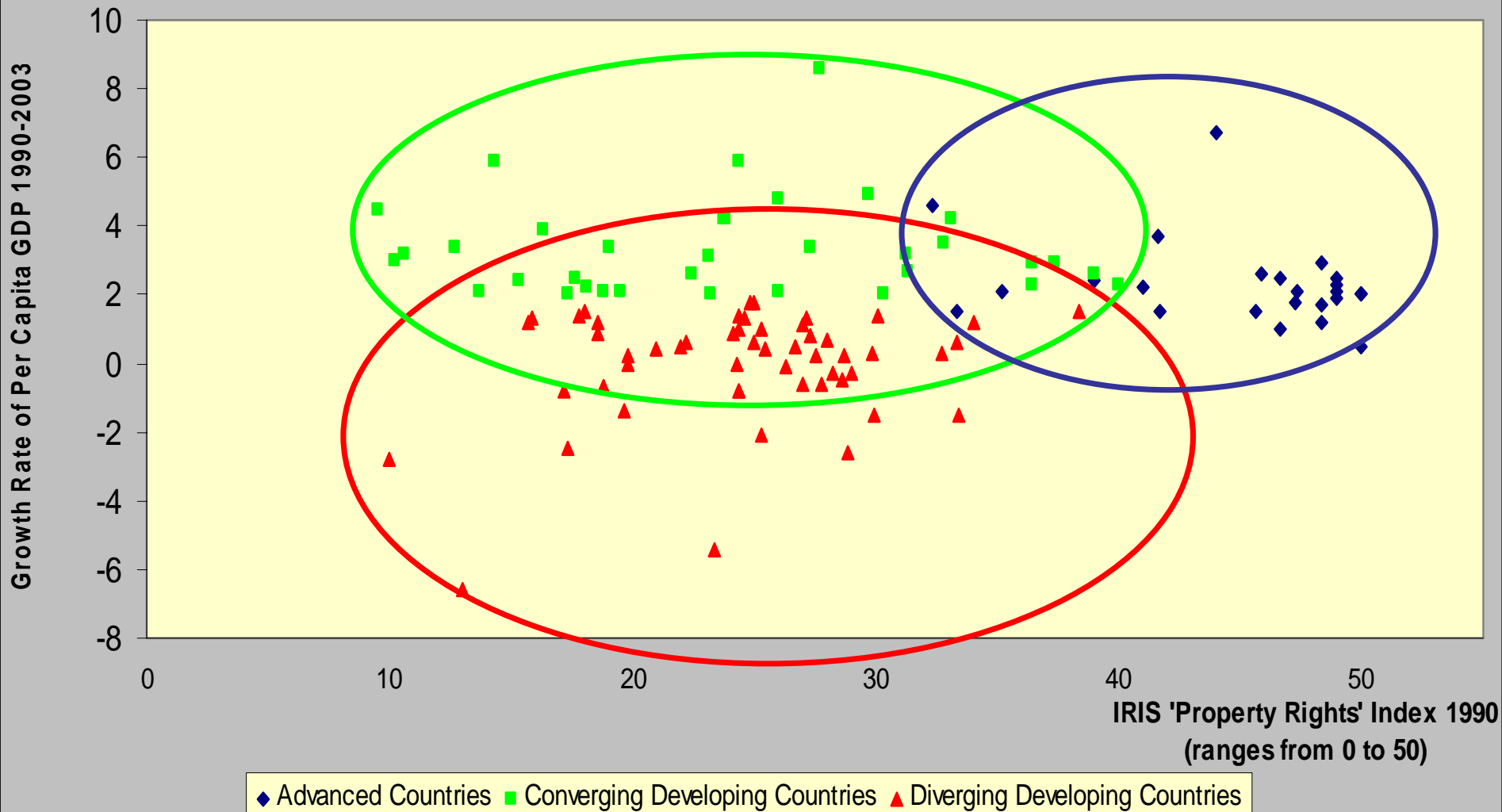


▲ Diverging Developing Countries

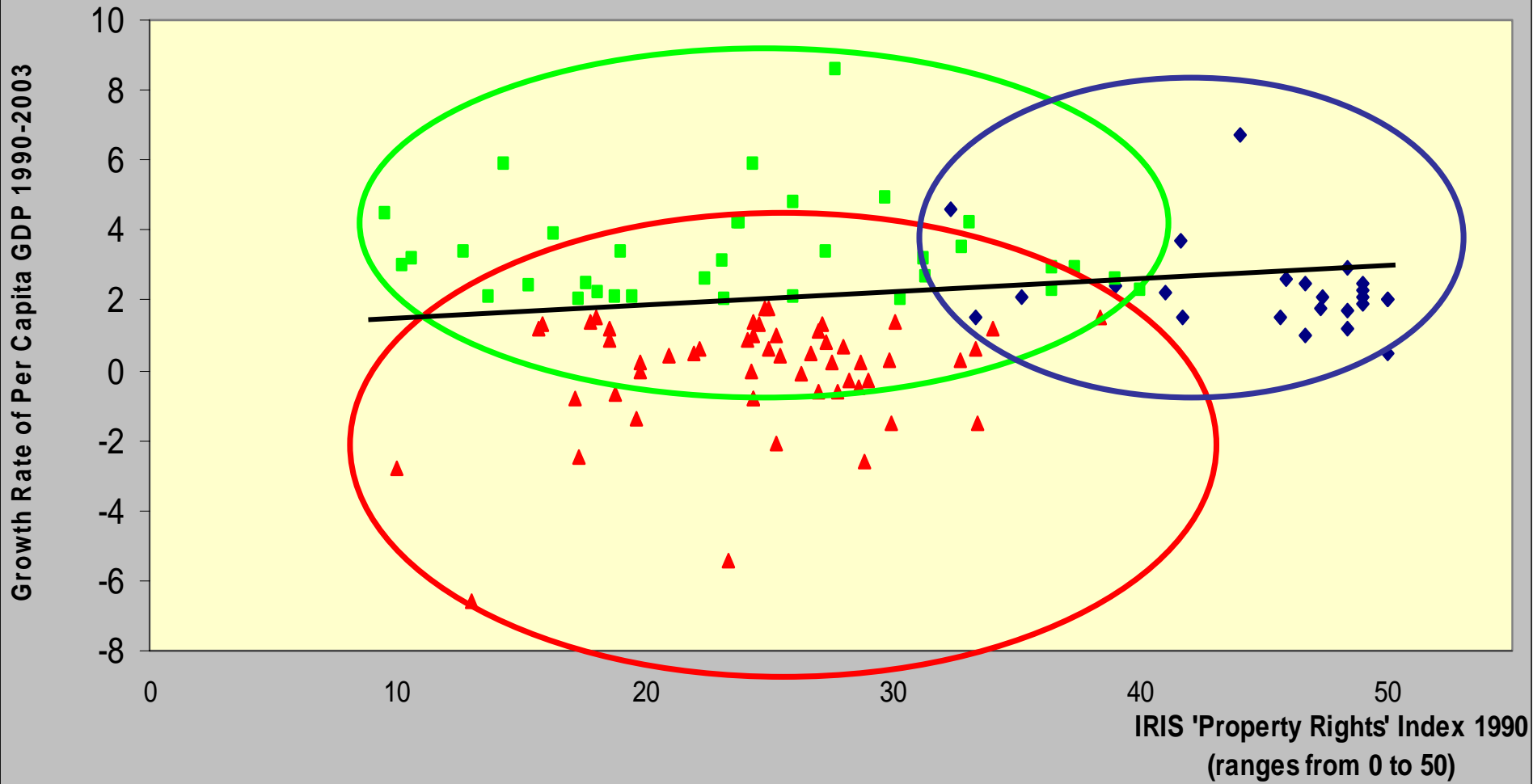
## Market-Enhancing Governance: Composite Property Rights Index and Growth (using Knack- IRIS data) 1990-2003



Market-Enhancing Governance: Composite Property Rights Index and Growth  
(using Knack- IRIS data) 1990-2003

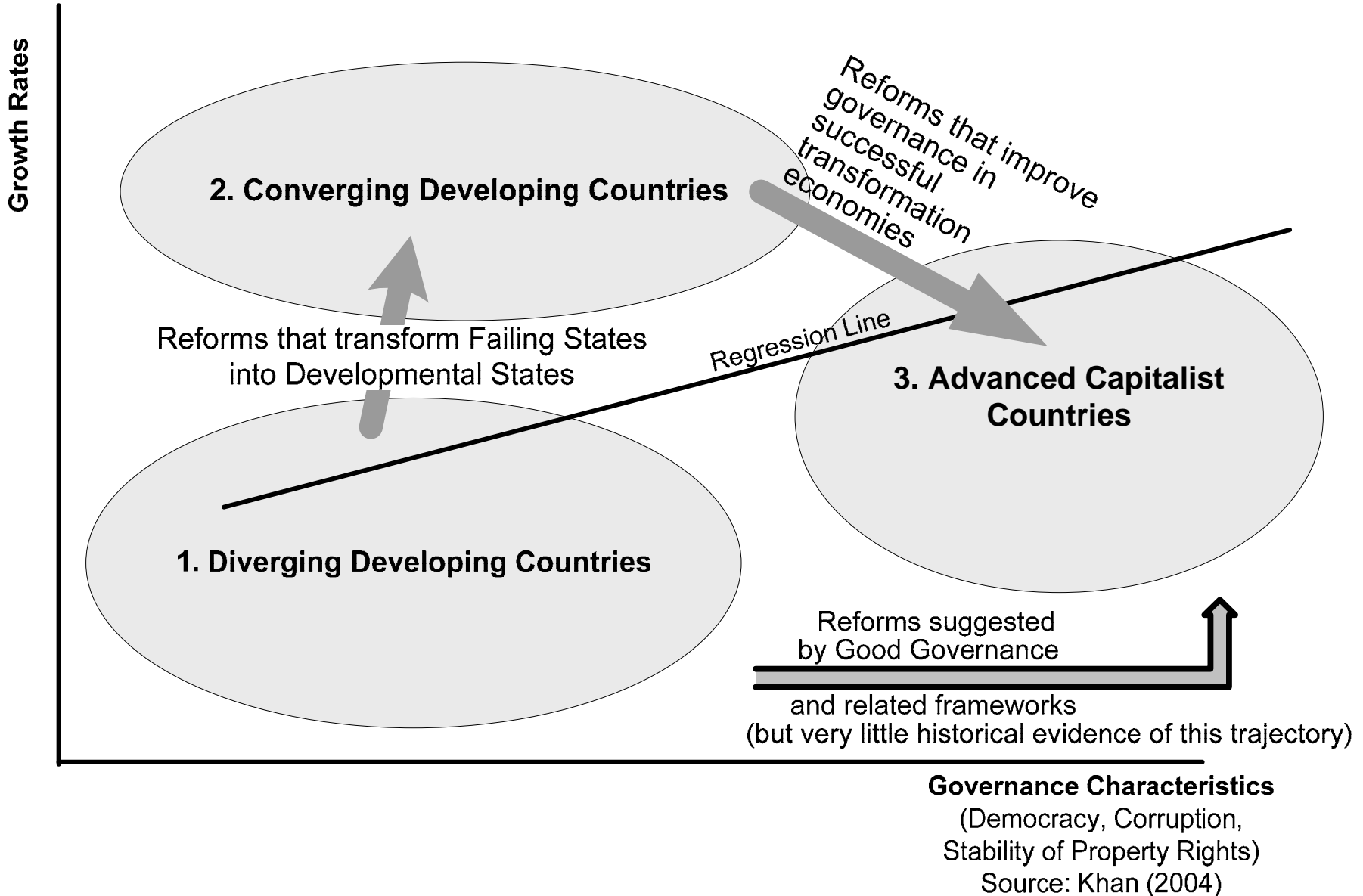


Market-Enhancing Governance: Composite Property Rights Index and Growth  
(using Knack- IRIS data) 1990-2003



◆ Advanced Countries    ■ Converging Developing Countries    ▲ Diverging Developing Countries

# State Capabilities and Reform Priorities



# 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

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

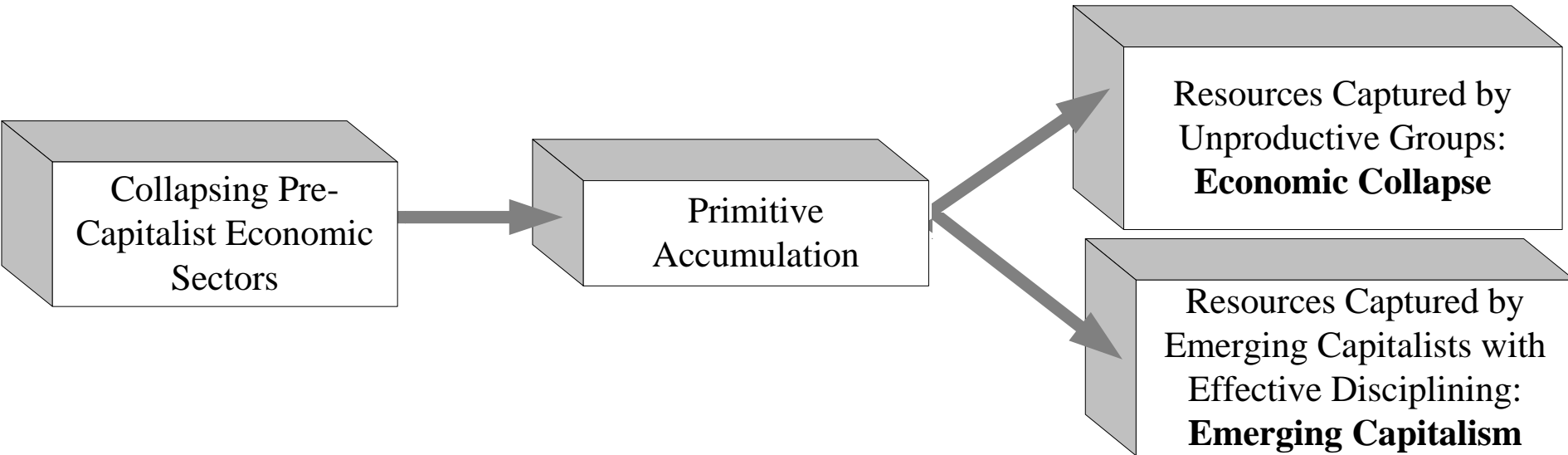
The second question is whether market-driven growth is sustainable: no clear evidence yet but theoretical doubts

Final question is what allowed some catching-up strategies to be sustainable

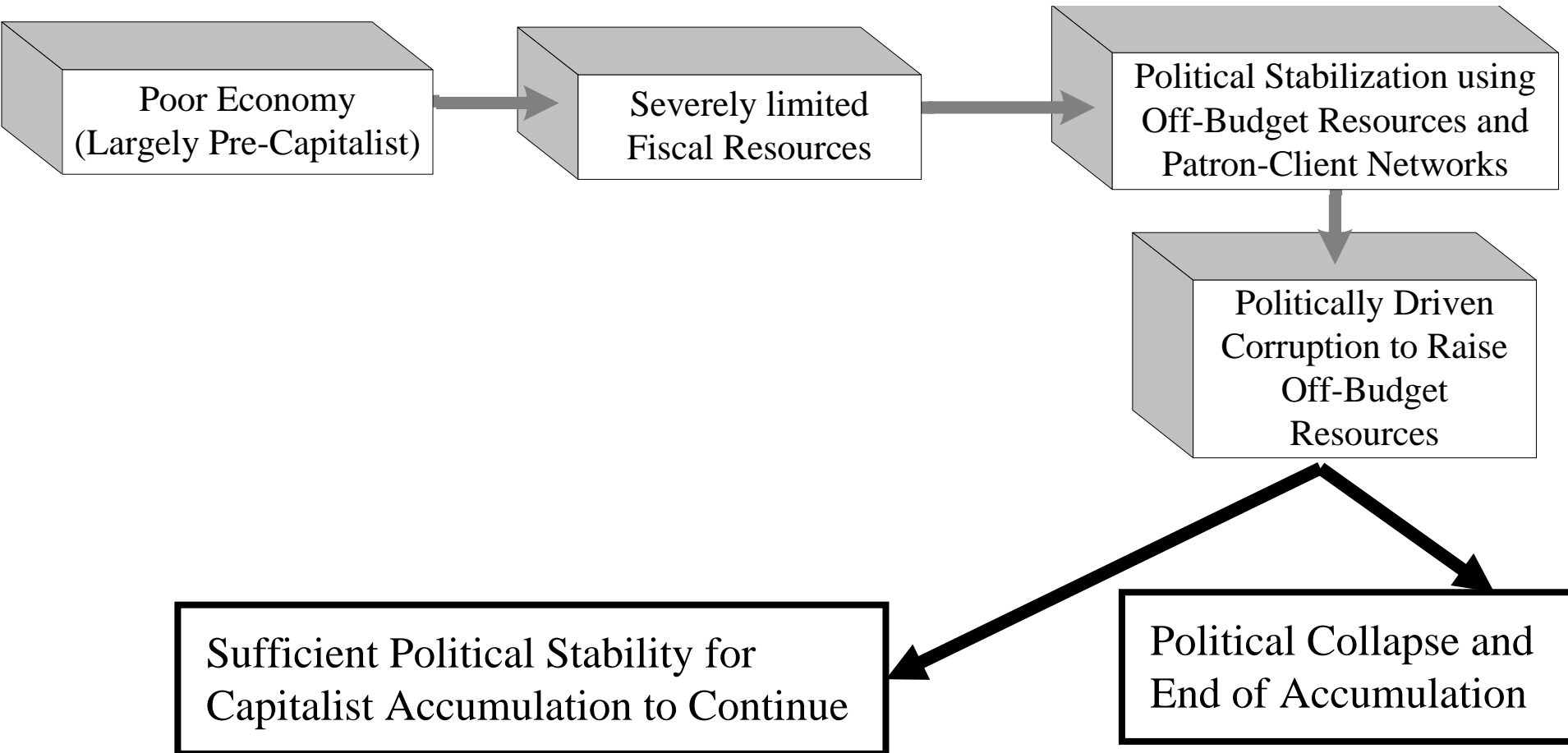
Stabilizing and protecting property rights is costly and assumes that most assets are already productive: managing non-market transfers is critical

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

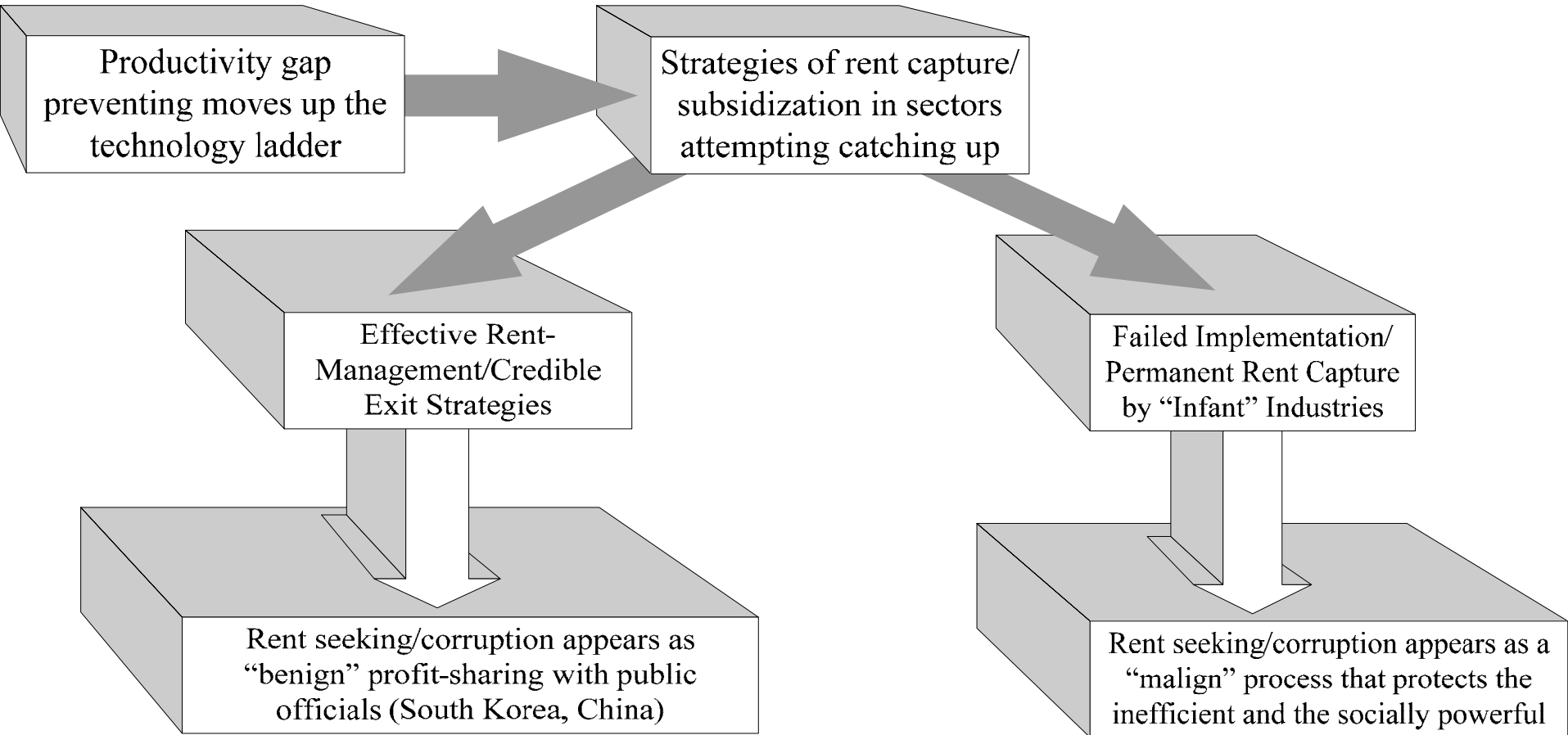
Catching up requires learning-by-doing. Managing this reasonably efficiently has large payoffs



# Politics is about patron-client redistributions



# But catching-up strategies do not always work



# The Political Economy of State Capabilities

	Industrial Policy Institutions (Rent Management Strategy)	Corresponding Political Configuration	Economic Outcome
South Korea 1960s	Targeted Learning Rents	Limited political power of intermediate class factions to protect inefficient capitalists	Rapid growth and capitalist transformation
Malaysia 1980s 1990s	Public sector and MNC-led technology acquisition	Powerful intermediate classes but centrally organized after 1980  Centralized transfers delink redistributive rents from learning rents	Rapid growth and capitalist transformation
Indian subcontinent 1960s 1970s	Targeted learning Rents, Public sector technology acquisition	Powerful and fragmented intermediate class factions protect inefficient rents  Learning rents regularly become redistributive rents	Many infant industries fail to grow up  Moderate growth and slow pace of transformation

	Industrial Policy Institutions (Rent Management Strategy)	Corresponding Political Configuration	Economic Outcome
Indian subcontinent 1980s 1990s	Liberalization and slow withdrawal of subsidies for learning.	Powerful and fragmented intermediate classes remain  Growing political fragmentation	Growth led by niche sectors. Higher growth than before but limited to already existing technological capacities
Latin America 1950s to 1970s	Selective tariffs, selective credit policy	“Corporatist” alliances between industrialists, intermediate classes and urban working class  Learning rents rapidly become redistributive rents	Initial rapid growth but running into stagnation  Many infant industries fail to grow up
Latin America 1980s onwards	Rapid liberalization	Widespread breakdown of corporatist alliances	Output growth but low productivity growth  Reliance on commodity production

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).