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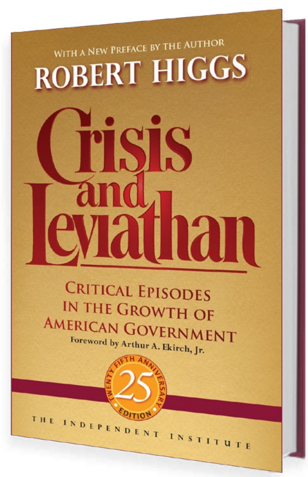

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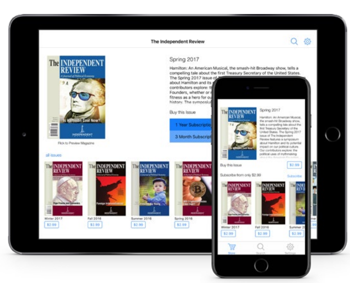

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Do Strong Governments Produce Strong Economies?

HILTON L. ROOT

Few terms are as ubiquitous as the *strong state* in the social sciences, yet there is no agreement on how to define it. The strong state crops up in the writings of economists, political scientists, and sociologists, who label it both a destroyer and a creator of wealth. It has been connected both to chronic underdevelopment and, just as frequently, to high levels of economic performance. If everyone knows what a strong state is, why do analysts disagree over its role?

In the conventional, "neoclassical" view of the state and economic development, two types of government exist—strong and weak—and the latter usually receives better grades for promoting economic performance (Klitgaard 1991). In this view, strong states typically choose interventionist strategies for development. This notion is based largely on examples of the strong states of Latin America, where state interventions in economic affairs include populism, import substitution, and regulatory manipulation of markets, often designed to obtain substantial and, typically, unsustainable redistributive goals (see Dornbusch and Edwards 1991).

The usual justification for developing countries to adopt strong activist states has been that the private sector would not provide the massive public investments needed for economic growth. In reality, however, strong states have often ended up pursuing power for the sake of their own leaders, and elitism, corruption, and misallocation of resources have resulted. Disillusionment with the performance of state-led growth strategies has caused critics to champion weak states, which foster growth by leaving markets alone (Friedman and Friedman 1980). The minimalist state is touted for doing no more than providing a stable, credible currency and a strong legal system designed to enforce private property rights and contract law. On the other hand, such

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weak states have historically been unable to prevent the capture and distortion of economic policy by oligopolies and rent-seeking elites.

The conventional language of *strong* versus *weak* thus fails to explain a government's ability to foster or hinder economic performance. East Asia's high-performing economies—South Korea, Malaysia, Taiwan, Hong Kong, and Singapore—have dramatically demonstrated the inadequacy of the traditional neoclassical categories. In East Asia, strong, not weak, states have enabled the private sector to make a major contribution to growth. Contrary to expectation, the weakest states in that region—Indonesia and the Philippines—have not nurtured strong private sectors; in fact, they have been much less successful than the others in generating home demand and in accumulating capital and skills.

In response to the economic successes of the activist East Asian governments, a new generation of statist scholars has emerged to advocate the role of a strong state in promoting economic development (see Campos, Levi, and Sherman 1994; Evans 1992; Johnson 1982; Wade 1990a, 1990b). The result is a strong polarity in the literature. In one camp, a strong state is viewed as an obstacle to economic development; in the other, state activism is touted as an essential component in the most celebrated cases of economic growth since the end of World War II. Both of these views contain important elements of truth, but both are too limited to account for the varied performance of developing nations.

Weak States

A weak government is handicapped by the inability to enforce property rights or even many of its own laws. Because of the legal inadequacy of a weak state, its interventions are based not on rules but on administrative or executive discretion; this practice results in corruption and opportunism rather than in supervision. In fact, insufficient legal clarity is often intentional, facilitating random interventions by political authorities. For example, to compensate for rampant tax evasion, governments in developing countries devise tax regimes that allow considerable official discretion in assigning rates. But the capricious application of expansive tax powers drives private firms into the informal sector. Deprived of these tax revenues, government cannot provide basic services such as law enforcement, and few benefits remain for those firms that do disclose profits. When transparency becomes a risk, firms have difficulty attracting capital, and government becomes weaker still.

When states are too weak to control their own officials, agents of the state may act independently of one another. A policy of reform may be announced by one part of the government, while another part blocks its implementation. The inability to enforce rules reduces private business activity unless some important actor of the state, such as the president's family or inner circle, intervenes—as, for example, in Indonesia under Suharto, the Philippines under Marcos, or Russia under Yeltsin. Political power is needed to defend property rights when the impartiality of the legal system is compromised or when the rules are themselves inadequate. When countervailing institutions such as an independent legislature or judiciary are weak, the leader can provide market access to chosen favorites in return for their loyalty, thus disabling the discipline of market forces.

Bureaucrats in a weak state learn to use their power and access to information to extract value from proposed economic activity rather than to promote that activity. With corruption flourishing at all levels of government (Shleifer and Vishny 1993), the deal-making authority of leadership becomes essential. In this regard, a weak state acquires the same market-destroying tendencies of strong discretionary states, in which property-rights enforcement is at the discretion of a handful of individuals.

Although weak states respond to interest groups, they often cannot enforce bargains made with important constituents. Interventionist rules typically cannot be consistently enforced. As a result, reform measures, property rights, and contracts are not durable because the state lacks the means to implement and maintain them. Unable to enforce these minimal conditions, weak states can rarely sustain competitive markets. Instead, networks of individuals with special connections to the political regime are needed to sustain trade. Inevitably, officials of weak states are likely to collude with select, but powerful, private groups to extract the nation's resources. A weak state easily becomes a predatory state.

Many of the postcolonial African states fall into this category. Publicly disinterested bureaucracies in which pay and promotion are linked to performance have not emerged, and existing bureaus have been further compromised by governments that disburse employment in exchange for loyalty. Dependency on foreign capital, including aid, has discouraged accountability to citizens and eroded national sovereignty. Ethnic, religious, and regional fragmentation has given rise to political parties that enjoy only narrow social support. Excessive centralization has often been pursued to overcome these forces of national disintegration. However, highly centralized governments have allowed bureaucracy to be replaced by a single-party or no-party system, with national planning bodies controlling public goods and services. Local governments, which are allowed neither independent judicial authority nor the resources to develop managerial and technical capacity, have failed to deliver basic services. The legislature and judiciary are dominated by the executive branch, eliminating independent oversight of budgetary allocations. The result of this excessive centralization has often been a weak state dominated by the unbridled discretion of the executive and degenerating into personal rule and kleptocracy. Support for government has collapsed, and many African states have become incapable of providing basic public order.

Strong and Unlimited States

Strong and unlimited states, too, can act in a discretionary fashion. Lacking constitutionally defined limits, they are likely to be both interventionist and confiscatory. Able to alter rights and markets at will, they are incapable of making a credible commitment to private-sector development. (Contemporary examples include Vietnam, Syria, Ethiopia, Iraq, and the former Soviet Union.) To induce participation in markets, strong and unlimited states must offer protection in the form of monopoly rights, preferential tariffs, or guild or trade-union privileges. The exercise of unlimited political discretion allows them to promise excessive benefits to win the support of particular groups. This practice, in turn, creates political risk, reducing economic investments and undermining the possible outcomes of reform. The irony is that because of the state's unlimited power, no contract either with the government or of interest to the government is secure. A strong and unlimited state has much in common with a weak state; both are likely to become predators of private-sector wealth.

Strong but Limited States

A third type of state, which arose in western Europe, is not only strong enough to establish and maintain property rights but constitutionally prevented from violating those rights. This state requires an administrative structure that keeps separate the economic and political activities of regime officials. Such states must be strong enough not only to adopt rules that can sustain a competitive private sector but also to prevent itself from responding to the political forces that inevitably arise to monopolize access to the marketplace. Only this type of state can ensure competitive access to open markets.

Strong but limited states are often mistaken for minimal states because in comparison with interventionist states they directly provide a relatively small number of goods and services. But the term *minimal* gives the impression of weakness, which is misleading. These states must instead be strong enough to withstand the political pressure on government to intervene in markets. Hong Kong under British rule was perhaps a perfect example of such a state, in which "positive noninterventionism" protected the market from pressure groups, rent seekers, and unscrupulous officials. Like the governments of western Europe and North America, those of other high-performing economies in East Asia—Japan, Malaysia, South Korea, Singapore, and Taiwan—all accepted limits on their discretion over private-sector profits. All adopted mechanisms to separate the political and economic functions of government and to protect property and contract rights. They did not employ the same mechanisms used by the states of western Europe, but instead devised systems that performed the same role (Campos and Root 1996).

Implications

In distinguishing strong but limited government from the conventional perspective that identifies only weak and strong government, we can make sense of both the advantages of each and the contradictions between them. In the conventional view, the two types of strong states are not distinguished. A state that carries out and maintains highly interventionist policies, such as import substitution or subsidization of a highly unionized urban workforce, is confused with a strong but limited state, which plays a neutral role in the allocation of rents and subsidies. Federalism in the United States, for example, offers an institutional foundation for a strong but limited state that is able to foster equitable growth (see Weingast 1995, 1997).

In many emerging states, technical and practical knowledge is unevenly distributed. Often a small group of local capitalists dominates local industry, agriculture, and access to the external market. The superior technical knowledge of these small groups forces the government to depend on them to build the market, which allows representatives from that group to gain control over the government's regulatory apparatus and ultimately over the state. When economic power is concentrated in a few governmental ministries, it is more vulnerable to capture than when decision-making powers are dispersed among institutions that have veto power over each other.

Strong but unlimited states often promote corruption and rent seeking, thus exacerbating social and regional inequality. As noted earlier, both strong unlimited and weak states are prone to plunder the markets. What neoclassical wisdom calls a weak state can often more aptly be described as a strong but limited state that can maintain the market, providing the necessary public goods while resisting capture by interest groups.

Although the champions of state activism raise reasonable doubts about the earlier neoclassical view, they do not explain why some strong states promote economic development, whereas others pursue policies that hinder it. After all, the majority of countries that have pursued activist policies have also experienced negative growth along with exacerbated social inequality. Even if we take at face value the arguments advocated by statists—that those states have made a direct and significant contribution to economic growth—these statists have done no more than show that this role for the state is feasible, something long known.

But why have some strong states promoted growth rather than other political goals? The conventional view offers little help. By contrast, the example of East Asia's successful regimes suggests that critical and durable limits are needed in order to channel government behavior into activities compatible with economic development.

Achieving Strong but Limited Government

The development of strong but limited government depends on the existence of institutions that create incentives for political officials to abide by limits on their power. In many reform environments, the desire to create strong but limited government often drives leadership to increase the executive's discretionary power. Mikhail Gorbachev in the former Soviet Union and Boris Yeltsin and Vladimir Putin in post-Soviet Russia succumbed to this approach. Many Latin American leaders have also been attracted to it. Reform by mechanisms such as presidential decree is a two-edged sword, however. On the benefit side, the reform-minded leader gains the power to design and implement a reform package by eliminating many of the veto sources blocking reform. On the cost side, all such reform programs can also be undone by decree and hence are only as good as the paper on which they are written.

For economic reform to be durable, it must be politically costly for authorities to renege on promises once they are made. As the American federalists realized, durability cannot depend on altruism. No government should expect public service to attract only godlike figures who always place the needs of the public before those of their families or friends. Institutions must be designed so that political actors have incentives to maintain and preserve the system, while carefully delineating where their power to intervene in private economic activity begins and ends.

A government's commitment to market-led growth requires the design of appropriate government institutions that ensure clear boundaries between private and public and that protect both property rights and agreements with the business sector. The creation of such boundaries will shift the investment horizons of investors toward the long term so that growth can be sustained.

Are boundaries that protect private wealth from government plunder more likely to be erected in weak or strong states? In their effort to establish competitive market economies, weak states often falter because narrow interest groups obtain control over the market, over the judiciary, and ultimately over the polity. Oligopolies often arise to overcome systemic market risk caused by the weak enforcement of laws and contracts. In countries as diverse as Indonesia, the Philippines, and Russia, elites have enough resources to block necessary reforms and to prevent the implementation of transparent governmental practices. Strong and unlimited states will falter because their leaders may refuse to implement reforms that dilute centralized power and allow a decentralized private sector to grow.

The Asian Miracle and the Sociology of the State

The successful economies of East Asia offer examples of strong states that have encouraged economic growth by institutionalizing the following limits on executive discretion: (1) channels of representation for businesses to induce them to make long-term investments; (2) wealth-sharing schemes to elicit the support of the wider population for development; (3) a competent bureaucracy that encourages credible government commitment to long-term, growth-enhancing policies (Root 1996).

Channels of Representation

The significant improvements in income distribution that accompanied sustained economic growth in the high-performing East Asian economies have resulted from effective use of public- and private-sector institutions and organizations. Common throughout East Asia are deliberation councils, which, although limited to particular sectors, offer input into the policy process and have veto power over the outcome. The councils provide greater predictability, improved transparency, and procedural guidelines and precedents for the exchange of views between leadership and the private sector. The leadership of East Asia generally has avoided undertaking major policy directives without first consulting with the major players targeted by the regulation. The councils have made information about who gets what from government a matter of record, thereby limiting the opportunities for preferred firms to engage in behind-the-scenes favor seeking or for private appropriation of gains from insider information. Ultimately, deliberation councils have served as commitment devices, helping to reduce the tendency of government to renege on contracts with private holders of wealth.

Wealth Sharing

A range of institutional innovations promoting broad-based health services, education, and housing was designed to make credible the regime's promise of shared wealth and growth. These efforts have enabled leaders to gain the cooperation of the citizenry. Businesses have invested in fixed capital because the potential risks of social unrest have been mitigated. Encouraged by anti-inflationary macroeconomic policies, the wider population has saved a considerable portion of their income and invested in education, confident of being able to enjoy the future gains. The introduction of institutions that encourage equitable growth was an explicit policy choice by government that has contributed directly to an improved investment environment.

Competent Bureaucracy

Sharp contrasts between the successful and less-successful bureaucracies in Asia are instructive. The bureaucracies of Japan, Korea, Singapore, and Taiwan as well as some bureaus in Malaysia and Thailand have enjoyed merit-based recruitment and promotion, well-defined career paths, competitive salaries relative to the private sector, pension systems, and the possibility of retirement to a board seat in a large private or public enterprise. All but Thailand and Indonesia have upheld harsh penalties for corruption, which has generated (relative) competence and integrity among bureaucrats. Even in the less-competent bureaucracies in Indonesia and Thailand, explicit spending limits and a binding commitment to monetary stability have limited discretion.

Improving the productivity of the civil service so that it would enforce rules and ensure standards was a first step in the encouragement of private-sector confidence among all of East Asia's high performers. The civil service has been rewarded for its conformity with agreed upon rules that circumscribe arbitrary and capricious interventions in its oversight of the economy. Merit has supplanted personal patronage, so that government is more responsive to general interests.

Although direct political participation has been weak, nonelites in all of the high performers have shared the fruits of growth, as evidenced by declining poverty and a reduction in income disparity. In fact, the countries that grew most quickly have had the most income equality. Wealth-sharing mechanisms have created opportunities for the nonelites to pursue productive rather than politically destabilizing activities. Moreover, growth-promoting policies have contributed to regime legitimacy, helping to encourage broad social support for the government. Although each country has determined its own specific pattern of institutional mechanisms and the purposes to which they are devoted, their experience shows that progress toward sustained, self-reliant, and more equitable development depends, in part, on the strength and quality of a country's institutional and organizational capacity. The creation and utilization of predictable procedures distinguishes effective development leadership. The difference between development based on political will and that based on institution building is essentially that the latter is sustainable, whereas the former is not.

As indicated by the successes in East Asia, western Europe, and North America, strong but limited states have historically had the best record for economic performance (Root 1989, 1994). Having defined the character of institutions that promote growth, we still are left with the conundrum of why only a small minority of world leaders have based their political survival on the competent selection of economic policies.

East Asia's success firmly supports the generalization that governments realize the goals of economic efficiency only when leadership depends on broad social foundations. The erection of such foundations continues to be the most elusive component of economic growth of states around the world.

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