

Economic Governance, Growth and State Capacity

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Annual Lecture



Issues

- There have been two major changes in thinking among economists in the past thirty years
 - A greater appreciation of the role of state effectiveness in shaping economic progress
 - The role of institutions in underpinning long-term success
- The progress of China has been a major influence on thinking in these areas
 - From the mid 1980s onwards, a more market-oriented approach to economic policy was pursued
 - But with a strong supporting role of the state.
- This confounds the standard dichotomy between market-led and state-led development
 - It emphasises the importance of achieving a balance.

Plan of the Lecture

1. Discuss the dimensions of state capacity and why it is important
2. Link to economic governance
3. Discuss implications for growth and stability
4. Final comments

The Theme of This Lecture

- In my own research, I have come to see the role of government through the lens of creating and enhancing state capacity.
- Core idea is that state capacity has three parts
 - Collective Capacity
 - Fiscal Capacity
 - Legal Capacity
- These underpin successful market economies
 - They require investments by the state and reflect the institutional structures and cleavages in place in a country.

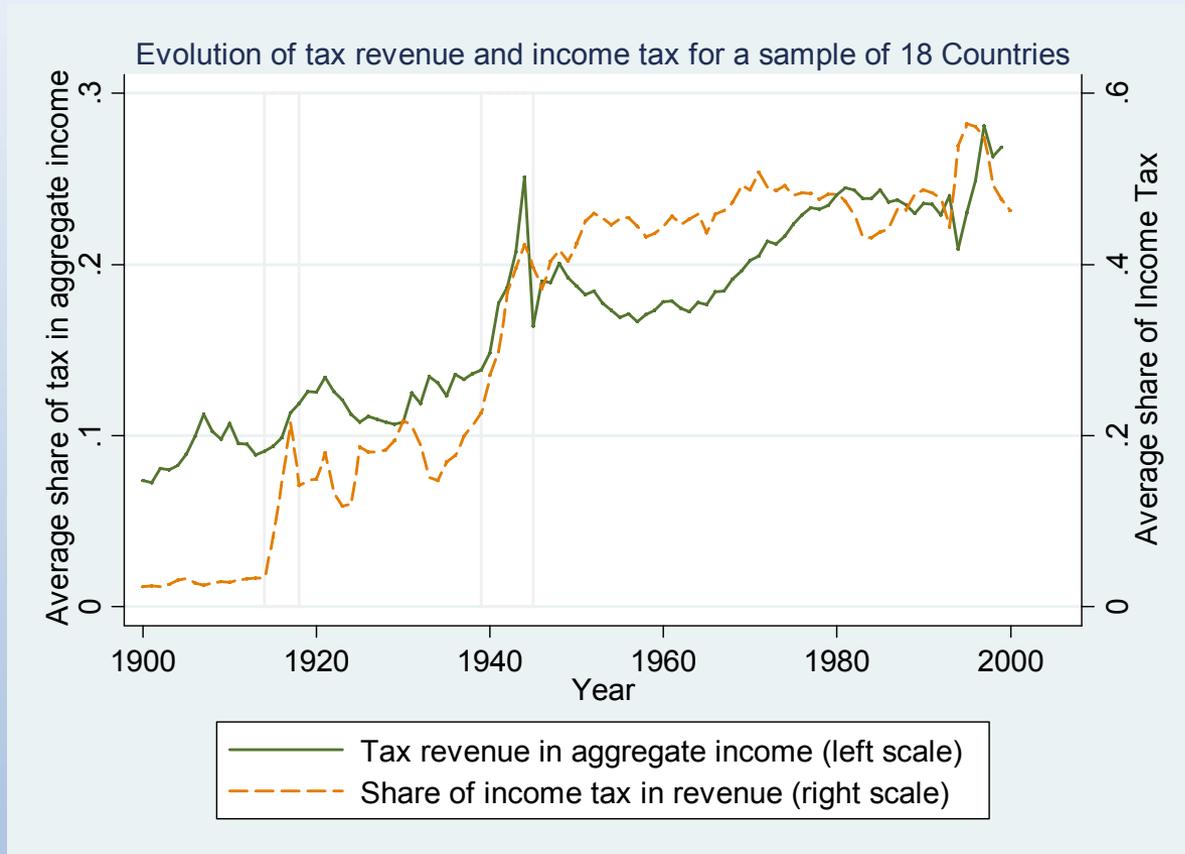
Collective Capacity

- How does the state deliver for its citizens?
 - Core range of collective goods such as
 - Education
 - Housing
 - health care
 - Redistribution between individuals and over the life-cycle
 - Support for the disadvantaged
 - Social security in retirement
- Requires investments in professional bureaucracy and the capacity to implement best practice
 - Evaluating policies

Fiscal Capacity

- The power to tax is one of the cornerstones of state power
- How do governments tax their citizens?
 - Broad-based taxation is attractive
 - Allows benefits of growth to enhance public budgets
 - Gives incentives for the government to pursue broad-based development
 - Tax systems need to be:
 - Fair – rules-based
 - Effective – based on investments in monitoring and compliance

An Overview of the 20th Century



The countries in this sample are Argentina, Australia, Brazil, Canada, Chile, Colombia, Denmark, Finland, Ireland, Japan, Mexico, Netherlands, New Zealand, Norway, Sweden, Switzerland, United Kingdom, and the United States.

Legal Capacity

- A fair and impartial legal system enhances a market economy by creating a level playing field
 - Individuals know that they will trade with each other on equal terms
 - Facilitates entry of new businesses
 - Security of property rights encourages investment and innovation
- Judicial independence gives reassurance on the impartiality of justice
 - And requires investment in a cadre of independent legal professionals.
- Law and regulation can work together.
 - Regulation needs to be subject to a clearly define legal framework

How to measure state capacity?

- This is not straightforward
- But here is a crude effort just to illustrate these ideas
 - Collective capacity is an index based on school attainment and life expectancy as measured in 1999.
 - Fiscal capacity is the share of income taxes in total revenue in 1999.
 - Legal capacity is an index of contract enforcement as measured by the World Bank's Doing Business in 2006
- We now plot these against each other coloring the dots according to the income level of different countries.

State Capacity Across Countries

Figure 2: Three Dimensions of State Capacity

