State Building: A Political Economy Perspective

Daron Acemoglu
MIT

Nemmers Lecture.
The Lay of the Land

**Figure:** The evolution of average GDP per capita in Western Offshoots, Western Europe, Latin America, Asia and Africa, 1000-2000.
In *Why Nations Fail*, James A. Robinson and I attempted to think about these issues in terms of a simple typology.

**Extractive economic institutions:** Lack of law and order. Insecure property rights; entry barriers and regulations preventing functioning of markets and creating a nonlevel playing field. Often designed by and for the benefit of the “elite”.

**Inclusive economic institutions:** Secure property rights, law and order, markets and state support (public services and regulation) for markets; open to relatively free entry of new businesses; uphold contracts; access to education and opportunity for the great majority of citizens.

Example of interactions: how did 17th-century Barbados maintain slavery?
Economic and Political Institutions: Synergies

- **Inclusive political institutions**: Made up of two separate conditions:
  - **pluralism**: broad distribution of political power and participation, constraints and checks on politicians, and rule of law (democracy necessary but not sufficient for this!).
  - **political centralization**: Weberian monopoly of legitimate violence over a territory and ability of the state to regulate economic activity, impose taxes and provide public goods—so as to avoid what Thomas Hobbes referred to as “war of all against all” leading to “solitary, nasty, brutish and short” lives of men.

- **Extractive political institutions**: Failure of either component.
The Logic of Extractive Institutions

- **Main thesis** of *Why Nations Fail*: growth is much more likely under inclusive (economic and political) institutions than extractive institutions.
- But why? Why wouldn’t every dictator, tyrant and elite wish to create as much wealth as possible?
- The reason is that growth, and inclusive institutions that will support it, will create both winners and losers.
- Thus there is a logic supporting extractive institutions and stagnation
  - **economic losers**: those who will lose their incomes, for example their monopolies, because of changes in institutions or introduction of new technologies
  - **political losers**: those who will lose their politically privileged position, their unconstrained monopoly of power, because of growth and its supporting institutions—fear of political creative destruction
  - both are important in practice, but particularly political losers are a major barrier against the emergence of inclusive institutions and economic growth.
No Political Coase Theorem

- An example to illustrate political losers (from Acemoglu, Egorov and Sonin “Dynamics and Stability of Constitutions, Coalitions and Clubs” AER 2012).
- Three economic and political states: elite control, institutional reform, democracy
- Two groups: the elite and citizens. The elite have political power initially, and if they choose to reform institutions, political power gets transferred to citizens with some probability \( p > 0 \).
- Payoffs from that three different states:
  
  \[
  \begin{align*}
  \text{Elite:} & \quad \text{democracy} \quad < \quad \text{elite control} \quad < \quad \text{institutional reform} \\
  \text{Citizens:} & \quad \text{elite control} \quad < \quad \text{institutional reform} \quad < \quad \text{democracy}
  \end{align*}
  \]

- If the elite is sufficiently forward-looking (discount factor sufficiently close to 1), then the equilibrium is: stay in elite control (no reform) \( \rightarrow \) Pareto inefficiency.
Unpacking Extractive Political Institutions

- **Political centralization**: Weber’s monopoly of violence and the capable, rational state backed by professional state and bureaucratic institutions—generally presumed to go together, but why?

<table>
<thead>
<tr>
<th>Lack of State</th>
<th>Distribution of Power</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Narrow</td>
</tr>
<tr>
<td>Political Centralization</td>
<td>Most extractive institutions (e.g., Latin America, most Sub Saharan Africa)</td>
</tr>
<tr>
<td></td>
<td>State building (e.g., China, North Korea)</td>
</tr>
</tbody>
</table>

Path 1 (e.g., England) → Path 2 (e.g., Prussia, Turkey)
The Rest of This Talk

- **Question 1:** Does political centralization matter?
- **Question 2:** What explains the distribution/positioning of countries in the previous table;
  - **Question 2a:** Why “strong democracies”. I.e., why do pluralistic societies tend to have political centralization?
  - **Question 2b:** Why most extractive political institutions lack full political centralization?
- **Question 3:** State building
  - **Question 3a:** What explains “extractive state building” (path 2 above);
  - **Question 3b:** Is path 2 the prelude to pluralism and inclusive political institutions?
**Question 1:** Does political centralization matter?

![Figure 1](image-url)

*Tax Revenue and Income 1990-2000*
Some Suggestive Evidence

- Boctstette, Chanda and Putterman “States and Markets: The Advantage of an Early Start” *JEG* 2002: positive cross-country correlation between a historical tradition of statehood and current economic performance.


State, Violence and Development in Colombia

- Revisiting the impact of state presence on economic development and the control of violence.
  - And can we just think of it as a local public good that can be provided by the community itself?
- Colombia: a perfect example for studying the relationship between state presence, violence and development
  - Huge problem of lawlessness and absence of state.
  - Recently, many areas of the country dominated by the ‘left-wing’ Fuerzas Armadas Revolucionarias de Colombia (FARC—The Revolutionary Armed Forces of Colombia) and ‘right-wing’ paramilitary groups
  - Very large differences across municipalities in state presence, violence and development.
  - Also important historical roots of state presence in Colombia, making an empirical strategy for estimating these effects feasible.
Origins of the Local State in Colombia

Recent work with Camilo Garcia and James Robinson: origins of the current state, for example as measured by state employees across different municipalities, going back to the colonial times:

- Variation across municipalities in colonial state presence and agencies (e.g., postal services, bureaucrats).
- Also variation across municipalities in distance to royal roads that Spanish conquistadors inherited and used as their network for reaching different parts of their colony.

These are potentially useful sources of variation:

- distance to royal roads and presence of colonial state lead to variation in the costs/benefits of subsequent state building
- royal roads no longer exist and colonial state presence should not have a direct effect on current outcomes.
Empirical Strategy and Results

- “Naïve strategy”: regress outcomes on current state presence instrumented by these variables.
- **Problem**: potentially misspecified, because state presence in the neighborhood matters.
- Model and estimate the effect of local state on violence and economic development (e.g., schooling, poverty and public goods) in own municipality and in neighbors.
- Local presence has a statistically and economically significant impact on violence and economic development outcomes in all municipalities, but it quantitatively similar impact on neighboring municipalities.
From our estimates, if we increase state presence in all municipalities below the 75th percentile to the 75th percentile value:

- Attacks by left-wing guerrillas would decline by 1.2 (median number of attacks is 6 in the 1988-2004 period).
- Secondary school attainment will increase from 58% to 79%.
- Poverty will decrease from 52% to 31%.

This underscores the importance of (local state) presence.

But it also highlights one of the difficulties of building the state:

- A lot of this is externalities. For example, without the externalities, secondary school attainment would have increased from 58% to 68.5%. Poverty would have decreased from 52% to 38%. Attacks by left-wing guerrillas would have changed insignificantly.
- These externalities are not internalized in local state building. It would be internalized by central state building if that were feasible.
Constraints on the Executive and Taxes

Figure 2
Tax Revenue and Constraint on the Executive 1990-2000

Source: "State Building: A Political Economy Perspective From Pluralism to Political Centralization"
From Pluralism to State Building

**Question 2a:** Why “strong democracies”. I.e., why do pluralistic societies tend to have political centralization?


In fact, the same happened after the English Civil War, when Parliament created the excise tax and eliminated venal officeholding.

Why?

Most plausible answer: because that was when interests are present in Parliament came to believe that they could control state spending and taxes, and direct this spending according to their interests (e.g., enforcement of Navigation Acts).

Thus:

pluralism $\rightarrow$ state building
Modeling Weak and Strong States

- Consider a model in which citizens invest in economic activity, and the ruler, controlling the state, invests in complementary public goods and also decides how much to tax economic activity.
- The tax is also constrained by:
  - *the economic power of the state*: the state cannot tax more than a certain maximum or incurs high costs of tax collection;
  - *the political power of the state*: the ruler can be replaced if the tax rate is too high.
- The paradox of state power:
  - If the state is politically strong, then it will also be difficult to replace (tending towards a narrow distribution of political power). But this will generally discourage investment.
  - If the state is politically and economically weak, then it will not have the capacity or incentive to invest in public infrastructure or even enforce law and order.
Modeling Consensually Strong States

But **consensually strong states** possible:

- These emerge under relative pluralism—when the distribution of political power is broad and effective.
- The state is economically empowered because citizens (or groups thereof) know that they can replace those controlling the state if the implementation of policies divergence from their interests.
- Potentially consistent with the first-order patterns in the data.

Hence the particular mechanism for:

\[
\text{pluralism} \rightarrow \text{state building}
\]
Political Bargains

- But if pluralism encourages state building, perhaps extending pluralism could be part of a state building strategy.
- Following the War of the Roses, Henry VII started the process of state building, particularly restricting the power of the barons and lords, culminating in the militia law putting their livery retainers under centralized control.
- But Henry VII and VIII still needed to prevent all the barons and other powerholders from rebelling.
- One interpretation of the empowerment of Parliament during this time is that this was a concession to these powerholders in the process of state building; “King in Parliament” as a Cromwellian strategy of state building (consistent with Geoffrey Elton, The Tudor Revolution in Government, 1953).
- Thus possibly:
  
  state building $\rightarrow$ pluralism
Barriers against State Building

- **Question 2b**: Why do most extractive political institutions lack full political centralization?

- Why wouldn’t every dictator or elite like to have as powerful a state as possible? Why wouldn’t they want to have the Weberian monopoly of legitimate use of violence and capable, rational bureaucracy?

  - See also Besley and Persson *Pillars of Prosperity: The Political Economics of Development Clusters*, 2011.
Barriers against State Building

- **Answer 1:** political losers again.
- Current elite in power and several competing elites
- Four economic and political states: weak state, transition (to state building), state building, and new coalition.
- The current elite has political power initially, and if it goes for the transition to state building, process political power may get transferred to a competing group of elites with some probability \( p > 0 \), who may then forge a new coalition excluding the current elite.
- Suppose that payoffs from that three different states are:

  \[\text{Elite: } \text{new coalition} < \text{transition} < \text{weak state} < \text{state building}\]

  \[\text{Challenger: } \text{state building} < \text{transition} < \text{new coalition} < \text{weak state}\]

- If \( p \) is sufficiently high, then the equilibrium is stay in weak state.
Barriers against State Building in Practice

- Many state building experiments do seem to lead to the formation of new coalitions—and the fear that they might, seems to prevent state building.

  - 15th century England: weak monarch, strong lords (barons and lords with their local armies and liveried retainers a real threat to central power); series of kings deposed before the War of the Roses, often triggered by threats of increased central power.
  - Tudor state building project in part an effort to reduce the power of these barons and lords.
  - This did indeed lead to the formation of new coalitions, for example, against Henry VIII during the Pilgrimage of Grace, and against Elizabeth I during the Northern rising (when previously warring Nevilles and Percies joined forces against the central state).

- Why does the state building take place at all? Often because even the “weak state” ceases to provide enough security to current rulers.
Local Elites vs. the State

**Answer 2:** resistance to state building from local elites.

Those in control of the central state may wish to extend the reach of the central state to local economies.

This would generally involve reforming and modernizing labor relations;

- Central elites would be in greater favor of this than local elites because they would not be be “economic losers” from such reform.
- Also because there are spillovers across regions—benefits of economic modernization in one area accrue to other areas through pecuniary effects.

But this will generally be resisted by local elites.

If local elites strong enough, then state building will not be attempted or will be limited.

Example: PRI’s state building project in Mexico and its limits in Chiapas and Oaxaca.
The Persistence of Southern Equilibrium

- **Example**: the inability (and the unwillingness) of the US federal state to change the “Southern equilibrium” after the Civil War.
- Major changes in de jure power (emancipation of the slaves and enfranchisement of blacks).
- But a new equilibrium with remarkably similar features to the antebellum system emerged.
  - Slavery gone, but low-wage, low-education block labor working in plantations continued with anti-vagrancy laws, anti-poaching laws (e.g., Alabama’s Black Code) and Jim Crow legislation.
  - Blacks were enfranchised, but de facto disenfranchised because of Ku Klux Klan violence and literacy tests and poll taxes for voting.
- Black congressman George Washington Julian:

  “Of what avail would be an act of congress totally abolishing slavery... if the old agricultural basis of aristocratic power shall remain?”
De Facto vs. De Jure Power in State Building

- From Acemoglu and Robinson “Persistence of Power, Elites and Institutions” *AER* 2008: important distinction between de jure and de facto power:
  - **de jure power** allocated and regulated by institutions;
  - **de facto power** generated by resources, solutions to collective action problems and coalitions, often based on control of local networks.

- Suppose that political decisions are made by those who are more politically powerful, and

\[
\text{political power} = \text{de facto power} + \text{de jure power}.
\]

- Political reforms change **de jure power** but not necessarily **de facto power** of local elites who may increase investment in de facto power

- Main results:
  - De facto power will undo some of the changes in de jure power.
  - In fact, without convex cost of investment, total political power will be **invariant** to moderate changes in de jure power.
Why Did the Southern Equilibrium Persist?

- Southern elites, which largely survived the Civil War, increase their investments in de facto power.
- But also Northern elites decided it was too costly to change the Southern equilibrium and perhaps beneficial to keep it.
  - Partly because of the coalition between the southern and northern parts of the Democratic Party.
- Hayes-Tilden agreement of 1877, pulling out Northern troops starting the “Southern Redemption”.
Weak vs. Strong States in Colombia

- **Answer 3:** possible *symbiotic* relationship between those controlling the central state and non-state actors.

- **Examples:**
  - Hayes-Tilden agreement;
  - the North-South relationship in Italy at unification;
  - Waziristan in Pakistan;
  - Kurdish areas in Iraq;
  - the Mafia in the south of Italy;
  - Colombia today.
Symbiosis between Weak and Strong States


- Potential electoral advantage for incumbent politicians favored by non-state actors able to coerce or influence voters. This then reduces their incentives to eliminate these non-state actors.

- **Implication:** non-state actors will tend to persist to the extent that they deliver votes to the incumbent executive and that this effect is larger in areas where the executive would otherwise not do well.

- Thus non-state (armed) actors can persist because they can be in a *symbiotic relationship* with the executive.

- In addition, policies chosen to appease non-state actors rather than provide public goods and services to the population.
Back to Colombia

- After the foundation of the AUC (United Self-Defense Organization of Colombia) by assorted paramilitary forces in 1997, a strategic decision was taken to influence national politics (possibly taken at Santa Fé de Ralito in 2001 where members of the AUC, politicians and members of congress signed a document calling for the ‘refounding of the country.’).
- The AUC influenced elections in many parts of the country, helping elect congressmen and senators (with coercion and fraud) in organic relationship with themselves or sympathetic to their causes.
- Thereafter (i.e., after 2001), the presence of paramilitaries in a municipality is robustly correlated with greater vote shares of ‘third parties,’ typically connected with paramilitaries and supporting right-wing positions.
- Also paramilitary presence correlated with ‘electoral concentration’ for Senate and Congress elections in 2002 and the vote share of Presidential Uribe, in 2002 and more so in 2006.
Extending the authority of the central state: Is the persistence of paramilitaries after the 2002 election is related to voting patterns in 2002?

The answer is yes: paramilitaries have tended to persist more in a municipality, the greater the vote share of President Uribe in 2002. This effect is smaller, the greater was the historical extent of conservative support in the municipality.

The intuition for this last finding is that in places with strong historical support for conservatives Uribe was confident of winning and therefore needs the support of paramilitaries less.
Incentives for State Building

Question 3a: What explains “extractive state building” (path 2).

State building will enable an individual or a group to become economically and politically more powerful.

It might also be triggered as part of a “defensive modernization” project.

But this will be constrained and discouraged by the considerations discussed above.
Growth under Extractive Political Institutions

- Though growth is much more likely under inclusive institutions, it is still possible under extractive institutions.

- Why?
  - The logic of extractive institutions: they have to produce some income and surplus to be extracted.
  - When relatively secure in their position, the elites may wish to increase the level of production in the economy to be able to extract more
  - Reforms, some type of “modernization,” may be a defensive move against internal or foreign threats.

- But the success of growth under extractive political institutions is closely linked to state building.

- Examples: 19th-century Russia, Prussia, 20th-century Turkey and contemporary China.
Limits of Growth under Extractive Institutions

- **Question 3b**: Is path 2 a prelude to pluralism and inclusive political institutions? Should we pin our hopes on path 1 or path 2 for the future?

- If extractive state building could achieve long-run growth, perhaps it would be viewed as an alternative path to “modernity”.

- This is the argument often advanced in support of the Chinese “authoritarian path to growth”.

- But this type of growth under extractive institutions (with some degree of political centralization) is quite different in nature from growth under inclusive institutions.

- In fact, it can work quite well at early stages of development because most growth will come from investment and imitation (Acemoglu, Aghion and Zilibotti, “Distance to Frontier, Selection and Economic Growth” *JEEA*, 2006. But it generates no creative destruction.

- Consequently, even though growth is possible under extractive institutions, this will not be **sustained growth**.
From Extractive State Building to Pluralism?

- This raises the possibility of an alternative path, perhaps similar to that pursued by South Korea or Taiwan.
- State building and extractive growth at the early stages, and then through the forces emphasized by Martin Seymour Lipset in the context of "modernization theory," extractive political institutions will naturally make way to include the ones.
- But the evidence does not suggest that such an automatic or natural path as possible.
- Acemoglu, Johnson, Robinson and Yared, “Income and Democracy” *AER* 2008: there is no support for modernization hypothesis.
  - And when such a transition takes place, as in South Korea, it is neither automatic nor conflict-free.
State Building in Turkey

- State building progress more defensively in the Ottoman Empire.
- Attempted by successive Sultans and by other elites, e.g., the Unionists, as a way of stemming the decline of the empire.
  - A strongly top-down, nationalist and repressive movement.
- Continued more successfully by Ataturk, who introduced modern political, legal and economic institutions, in a top-down manner.
- Authoritarian and coercive.
  - Many executed for resisting the authority of the state, even for refusing to switch to a “modern” dress codes.
- The Turkish Republic did achieve some growth, but unstable, and very much based on businesses relying on state connections.
- **Legacies:** the extractive path to state building cemented the narrow distribution of political power.
  - The state became more powerful and those controlling it more entrenched, and future challenges likely to come from those wishing to control it for their own benefit. Significant discontent and backlash.
Goldilocks of State Building

- Perhaps a better way of thinking of the dynamics of pluralism and state building is like a “balanced race”.

- If one pulls ahead too far, it might make it difficult for the other one to ever catch up.

- Related to the idea that income and democracy are positively correlated not because of modernization, but because of joint development.

- All of this a cautionary note for the historically common and politically expedient course of supporting extractive state building.
Goldilocks of State Building in Action

- In fact, examples of more gradual state building may lead to more stable outcomes:
  - English state building: establishing a military power of the central state, confiscating church lands and building up state institutions (separated from the private household of the King) at the same time as partially empowering Parliament (in justifying taxation for the benefit of the Commonwealth);
  - making use of existing patrimonial relationships, e.g., Mexico, Botswana or even 15th and 16th-century England,
  - but paradoxically, this goes very much against the Weberian conception.

- Pitfalls in Afghanistan?
Conclusion

- Much of political economy, including my own work, has ignored the dynamics of state building and political centralization.
- These might be as important for the emergence of “inclusive political institutions” capable of supporting long-run growth.
- But they may also create tensions with other dimensions of inclusive political institutions.
- Much theoretical and empirical work, informed by history and our existing addresses and political economy, necessary to address these questions.