Pillars of Prosperity

The Political Economics of Development Clusters

Chapter 1: DEVELOPMENT CLUSTERS

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Outline

1. Motivation, Objectives and Background
2. Book Outline

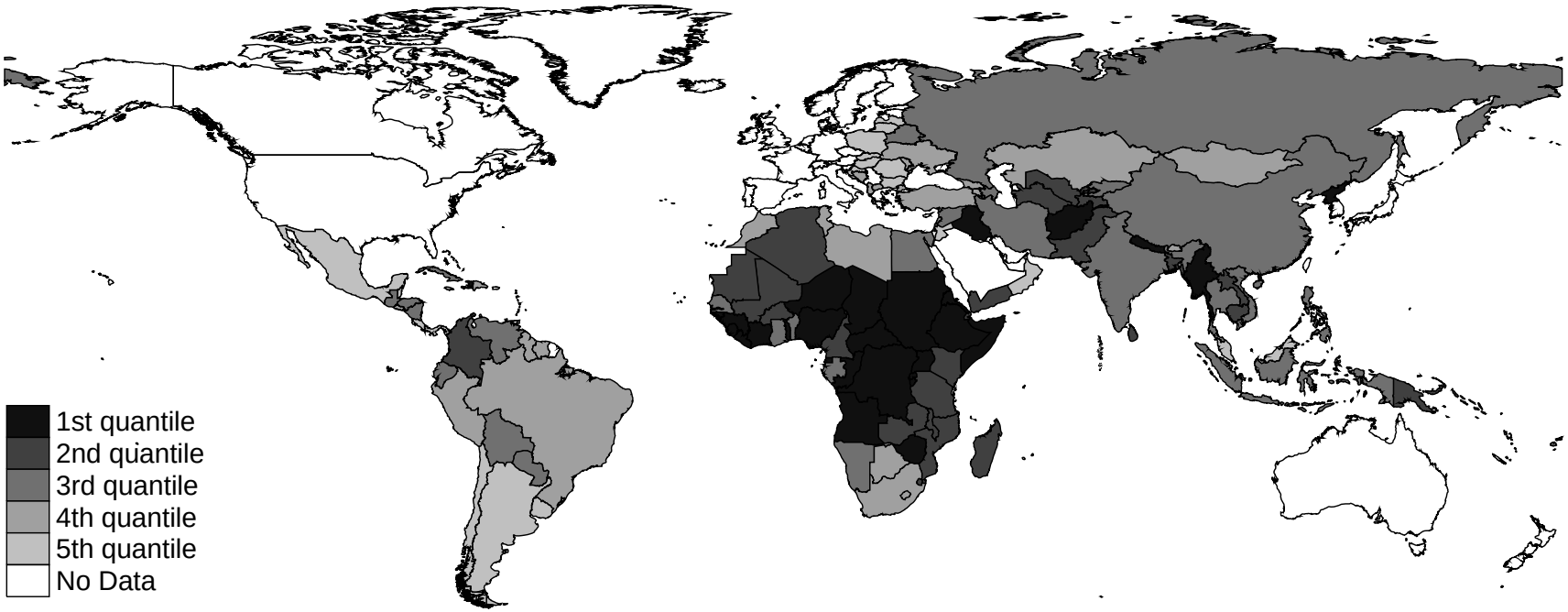
Huge Income Disparities

- Massive gap between rich and poor countries
  - ratio of income per capita on the order of 200
- Why are some countries rich and others poor?
  - classical question in economics, and in other social sciences
  - also of paramount importance for donors in various forms of development assistance
- But development not only about income
  - very clear in policy discussion about weak (fragile) states

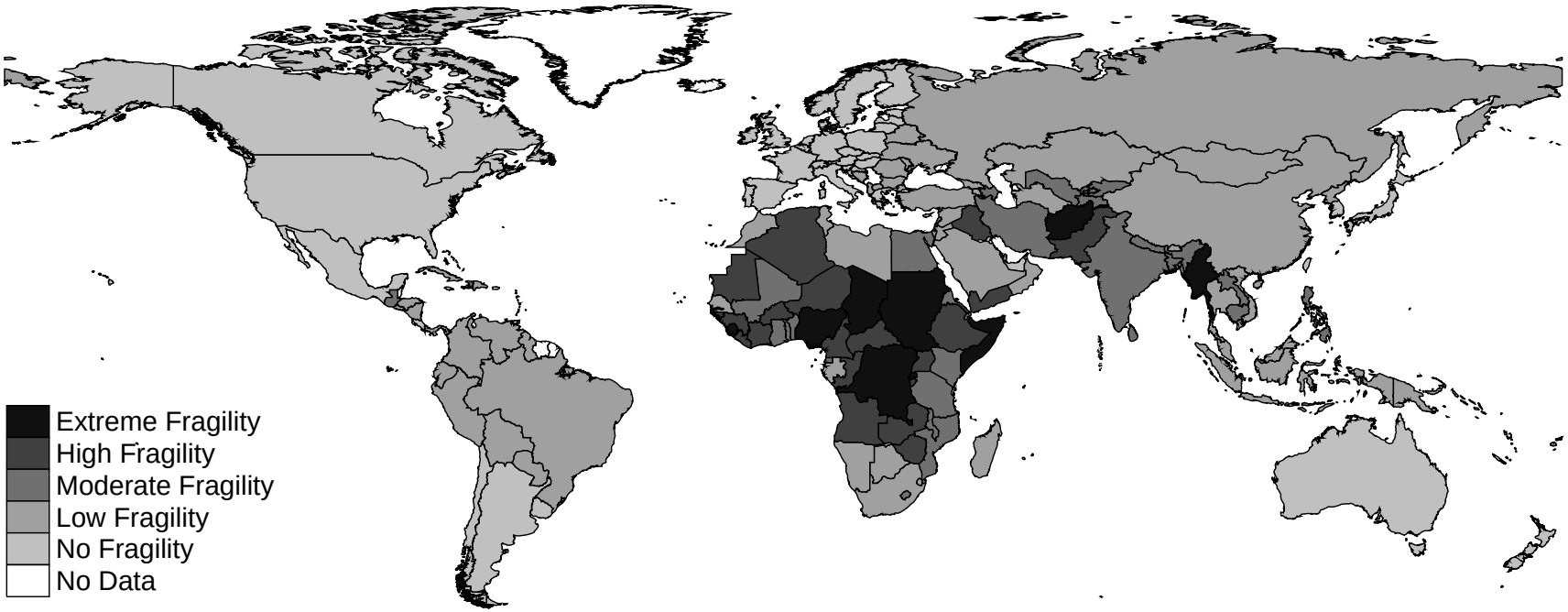
Weak (fragile) states - figures 1.1 and 1.2

- Central concept in development policy community
  - subject of various initiatives
- What is a weak (fragile) state?
  - it can not support basic economic functions, raise any substantial revenues, deliver basic services, keep law and order, ...
- Existing indexes
  - examples from Brookings Institute and Polity IV projects, though definitions appear to mix up symptoms and causes
  - incidence depends on definition, but 20-30 states failed/very weak, equally many fragile/weak, and others in risk zone
  - concentration in Sub-Saharan Africa, south/central Asia

Brooking Institute Index of State Weakness (2008)



Polity IV State Fragility Index (2008)



Development Clusters

- *State institutions* link with *income*, but also with *violence*
  - weak states in countries with massive poverty and societies plagued by internal conflicts
  - developed countries: high income, institutions work, policies in good order, conflicts resolved peacefully, ...
  - strong clustering of state capacity in different dimensions few strong economies with weak states
- Multidimensional problem — *the* development problem?
  - clustering of low income, violence, and a number of dysfunctional institutions

Example of Clustering - Figures 1.3 - 1.5

- Two forms of *state capacity*
  - extractive capacity: e.g., infrastructure to raise taxes from broad bases, like income or value added
  - productive capacity: e.g., infrastructure to enforce contracts or protect property rights
- Illustrate with two specific measures
  - alternative measures produce similar results
  - *fiscal* capacity: total taxes as share of GDP in 1999 (IMF data)
  - *legal* capacity: index of protection of property rights in 1997 (ICRG data)
  - strongly positively correlated with each other, income per capita (Fig 1.3), prevalence of civil war (Fig 1.4), and fragile state indexes (Fig 1.5)

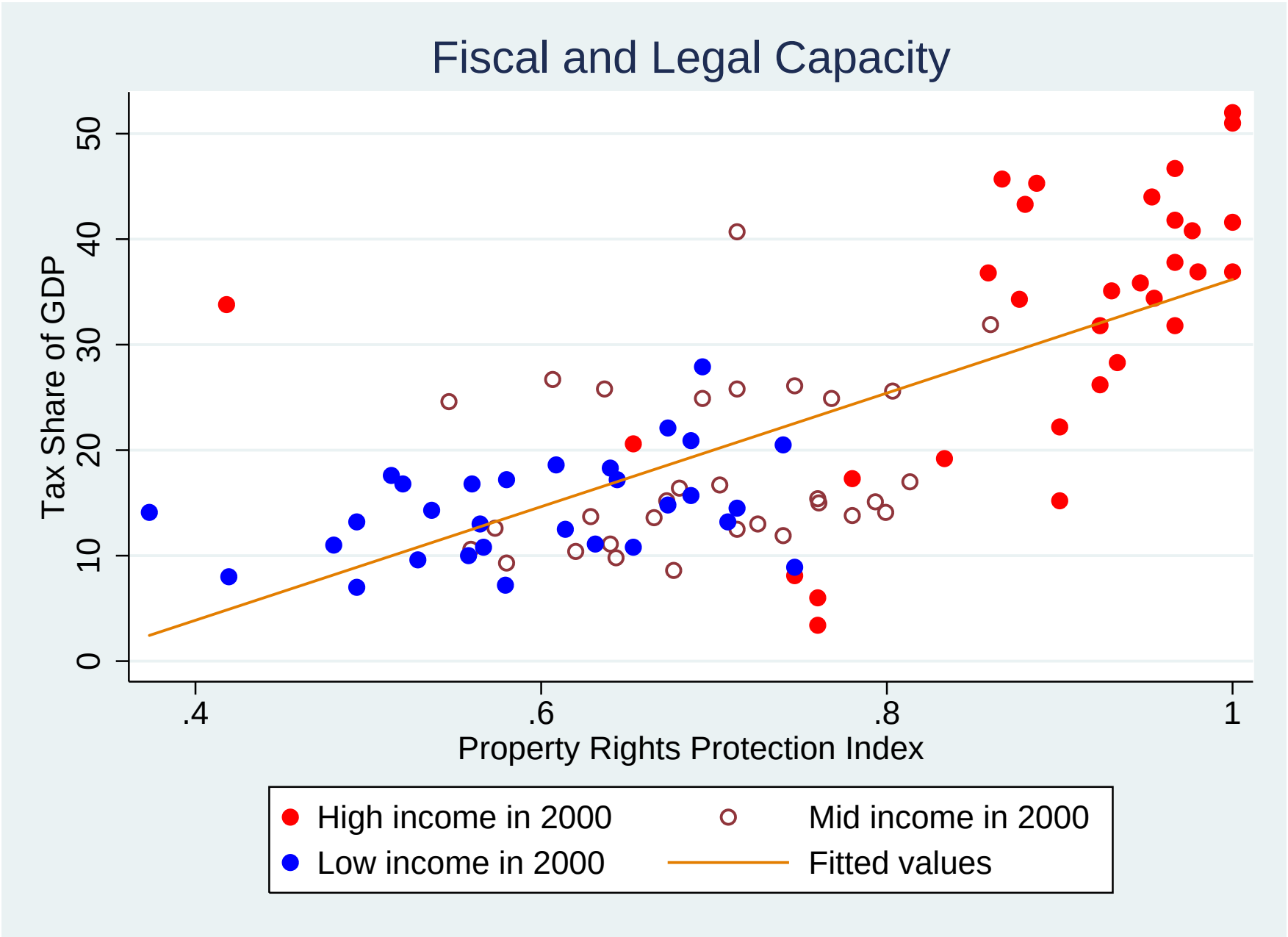


Figure 1.3 Legal and fiscal capacity conditional on income

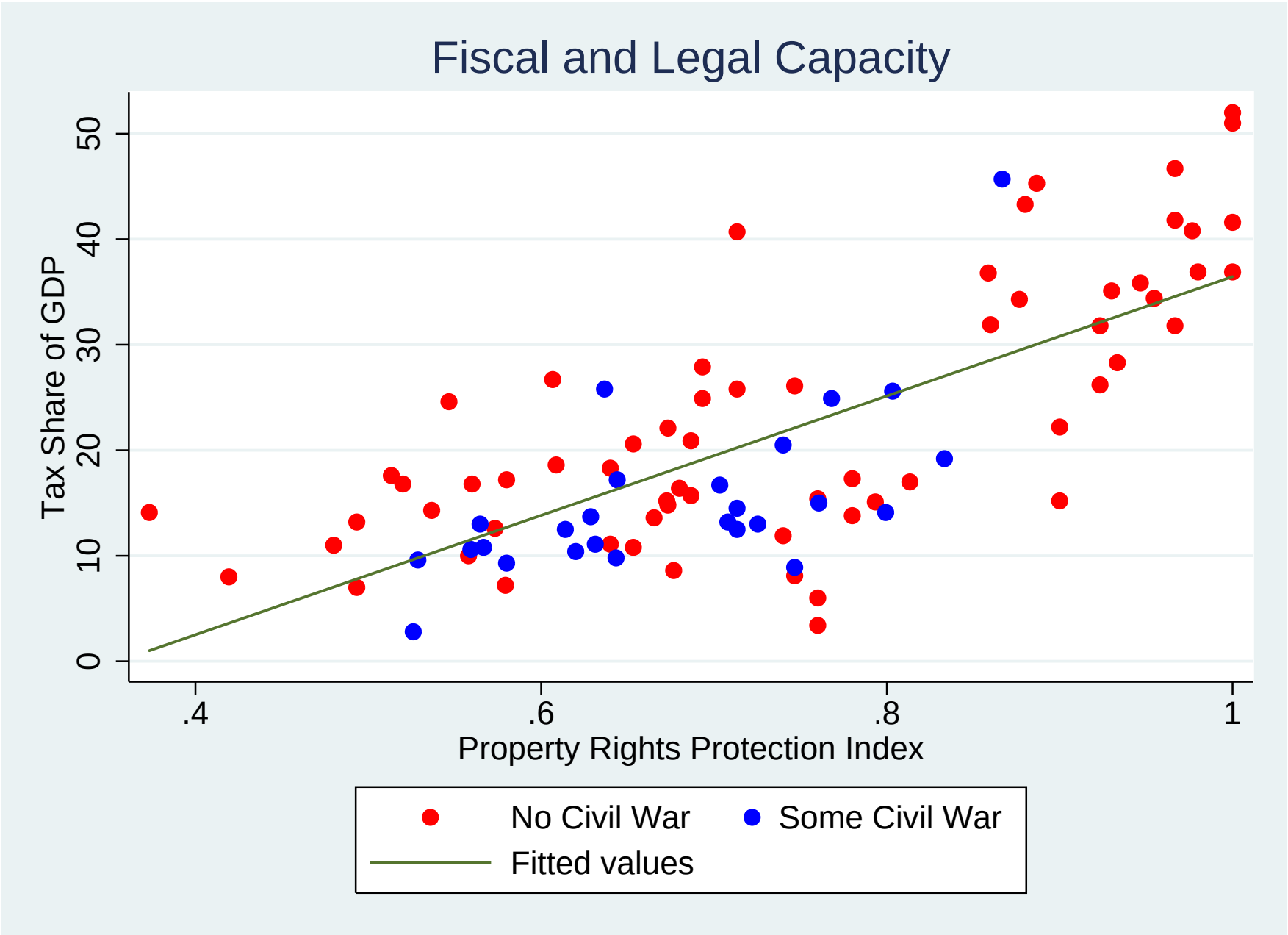


Figure 1.4 Legal and fiscal capacity conditional on civil war

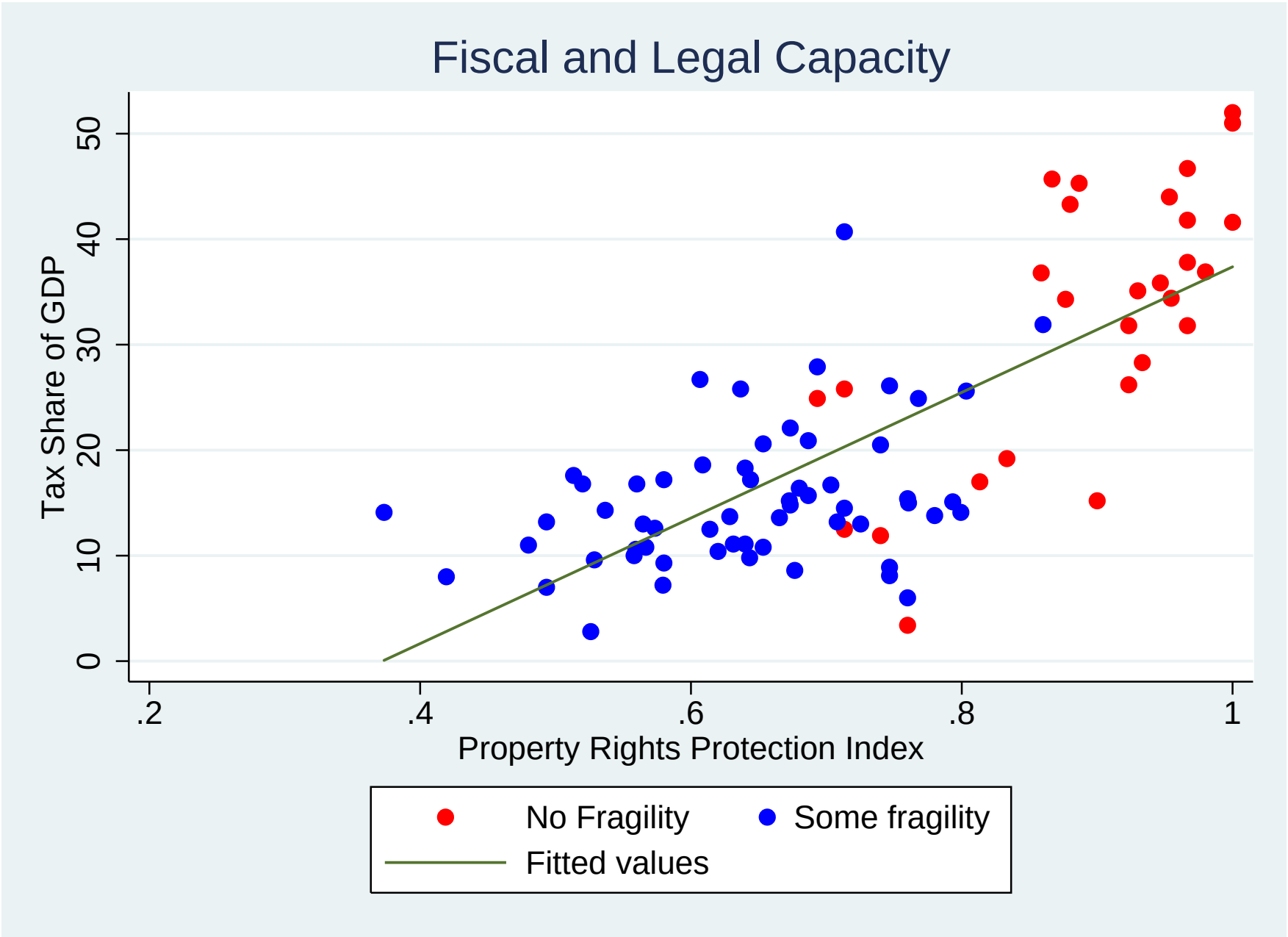


Figure 1.5 Legal and fiscal capacity conditional on fragility

How understand such patterns in the data?

- Basically need to pose — and answer — three general questions

Question 1

What forces shape the building of different state capacities and why do these capacities vary together?

Question 2

What factors drive political violence in different forms?

Question 3

What explains the clustering of state institutions, violence, and income?

Scope of the Book

- Some over-arching objectives
  - analyze the politics and economics of state building and political violence in the process of development
  - try to understand the observed development clusters of institutions, income, and violence
  - aim at constructing new theory and uncovering new evidence
  - hope to bring state capacity into mainstream of economics
- Pool together four broad research agendas
  - determinants of long-run development
  - determinants of different forms of political violence
  - importance of history in explaining today's patterns of development
  - interaction of economics and politics in shaping of societies

Background - earlier and ongoing research

- "Wars and state capacity", JEEA, 2008
- "Repression or civil war?", AER, Papers and Proceedings, 2009
- "The origins of state capacity: Property rights, taxation and politics", AER, 2009
- "State capacity, conflict and development", Econometrica, 2010
- "The logic of political violence", QJE, forthcoming, 2011
- "Fragile states and development assistance", JEEA, forthcoming, 2011
- "Weak states and steady states: The dynamics of fiscal capacity", mimeo (3rd coauthor Ethan Ilzetzki), 2010
- "From trade taxes to income taxes: Theory and evidence on fiscal capacity and development", mimeo, 2010

Outline

1 Motivation, Objectives and Background

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Overview

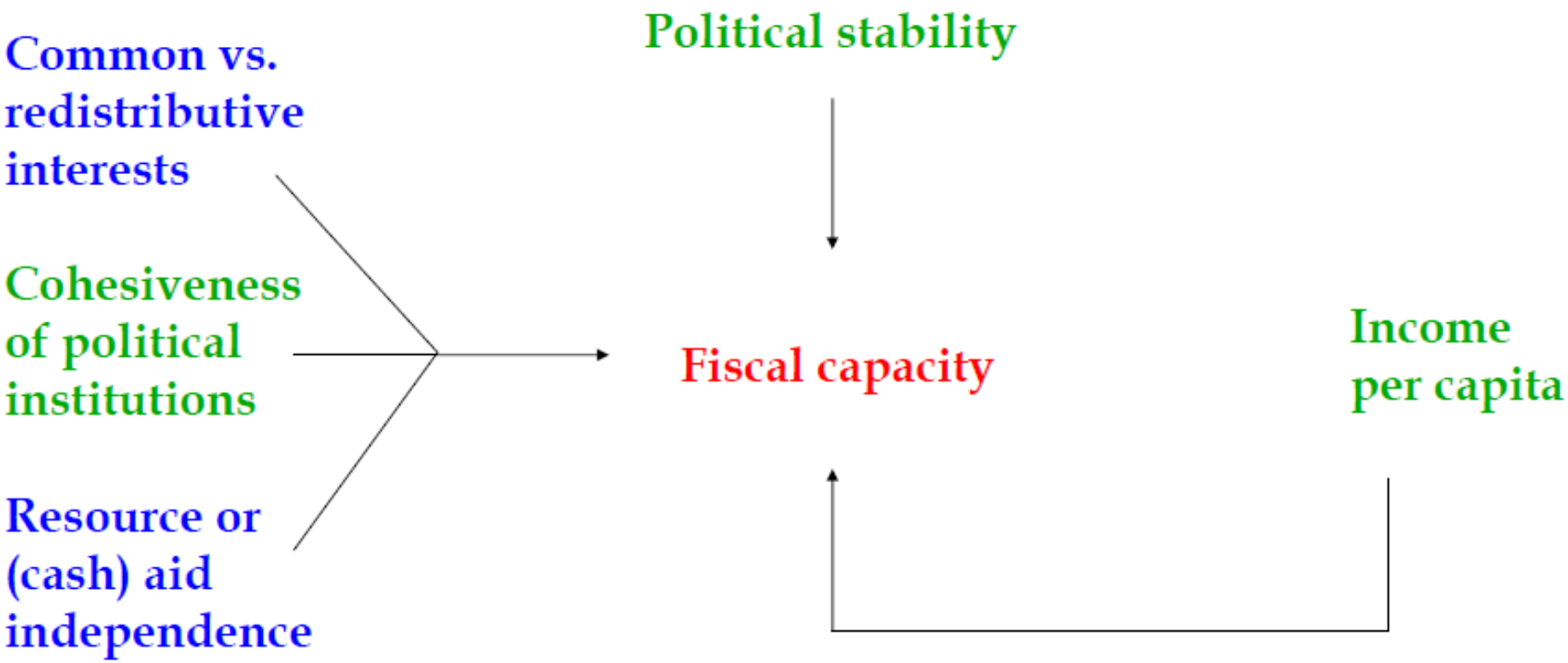
General modeling approach

- Analytical building blocks
  - two groups that can alternate in power
  - distinguish policy and institutions, which constrain policy
  - purposeful investments in institutions and in violence
- Build analysis successively
  - start by simple framework with a single dimension for policy and investment, constrained by number of parameters
  - gradually endogenize several of these parameters — turn them into new endogenous variables
  - revisit data as we go along

Chapter 2 – Figure 1.6

- Investments in fiscal (extractive) capacity
  - solve simple investment problem under uncertainty
  - uncover proximate and ultimate determinants
  - find analytical typology with three types of states
  - look at the data
- Deepen and broaden basic framework
  - microfoundations for fiscal capacity
  - more general models of public goods
  - polarization between groups
  - tax distortions
  - other tax bases than income
  - income inequality and size asymmetry
  - infinite horizon

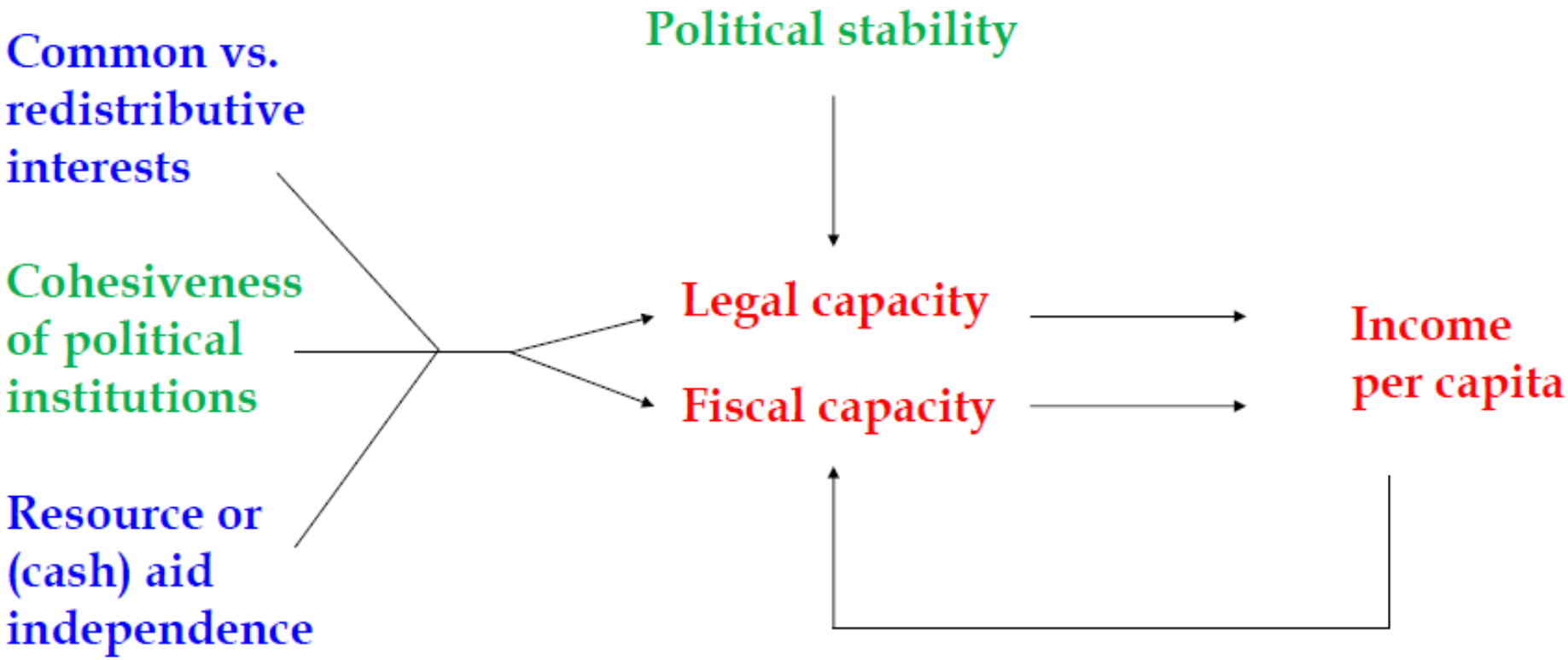
Figure 1.6 Scope of Chapter 2



Chapter 3 – Figure 1.7

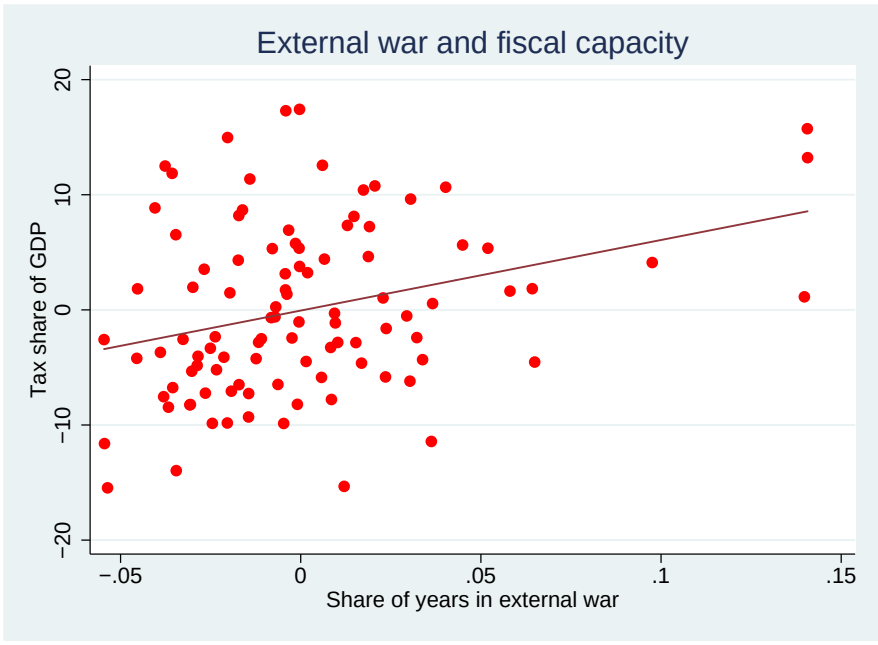
- Add investments in legal (productive) capacity
  - endogenize income
  - basic complementarity of two types of investments
  - perform comparative statics and look at data
- Deepen and broaden basic framework
  - microfoundations for legal capacity
  - production inefficiencies and rent seeking
  - additional sources of complementarity
  - private capital accumulation
  - predation and corruption

Figure 1.7 Scope of Chapter 3



Determinants of state capacity

- The use of public revenue: common interests implies higher investments in state capacity
  - external wars (partial correlations with state capacity – figure 1.8)
  - ethnic homogeneity
- Political institutions: cohesive political institutions increase investments in state capacity
  - executive constraints varialbe in Polity IV (partial correlations with state capacity – figure 1.9)
- Political stability: in the absence of common interests and cohesive political institutions, high instability may stop investments in fiscal capacity.
- Economic structure: higher share of resource revenue or cash aid in income that goes to the government diminshes incentives to invest in state capacities.
- Income per capita: higher income increases incentives to invest in state capacities.



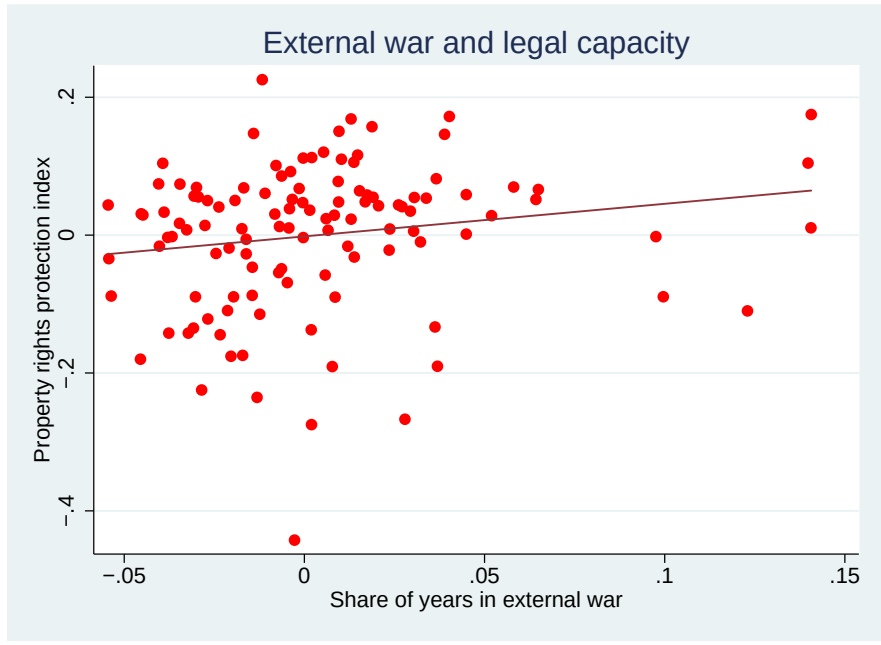
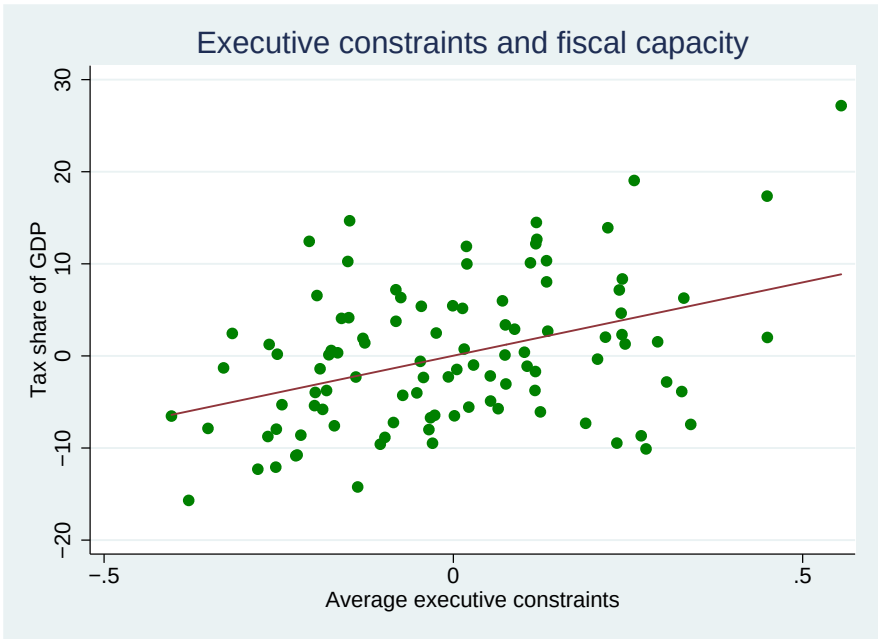


Figure 1.8 State capacity and external war



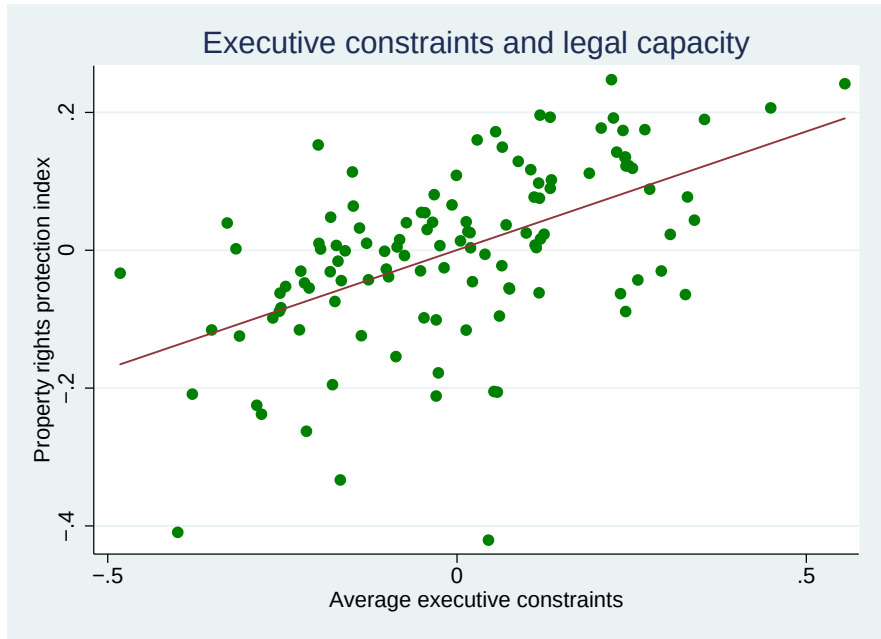
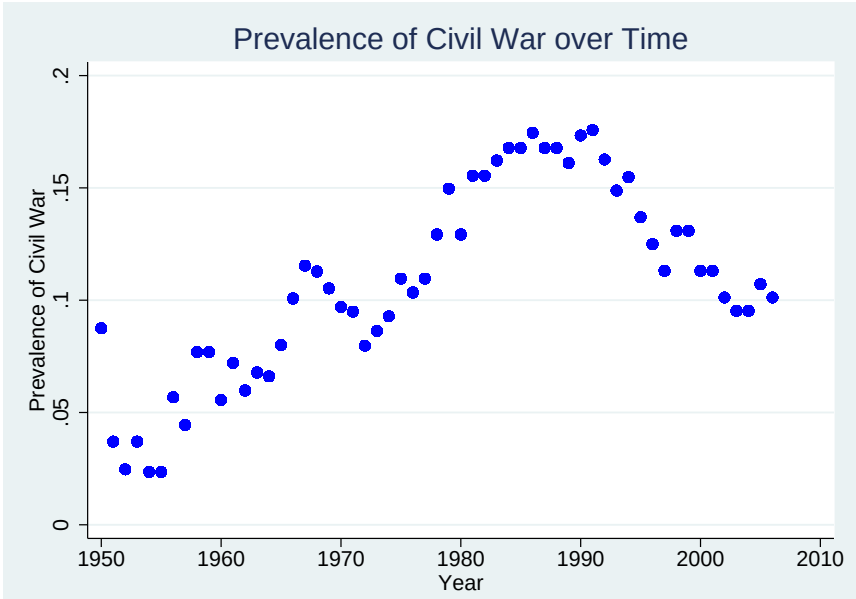
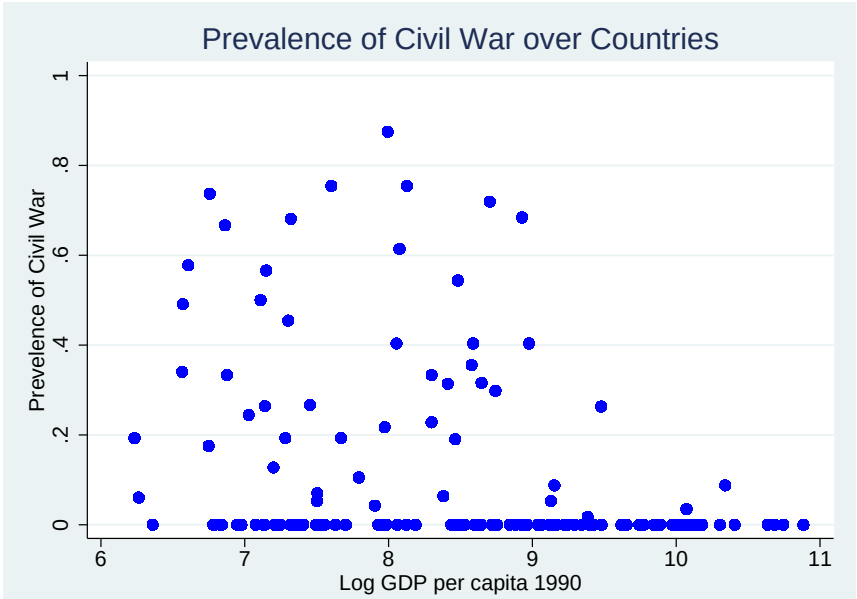


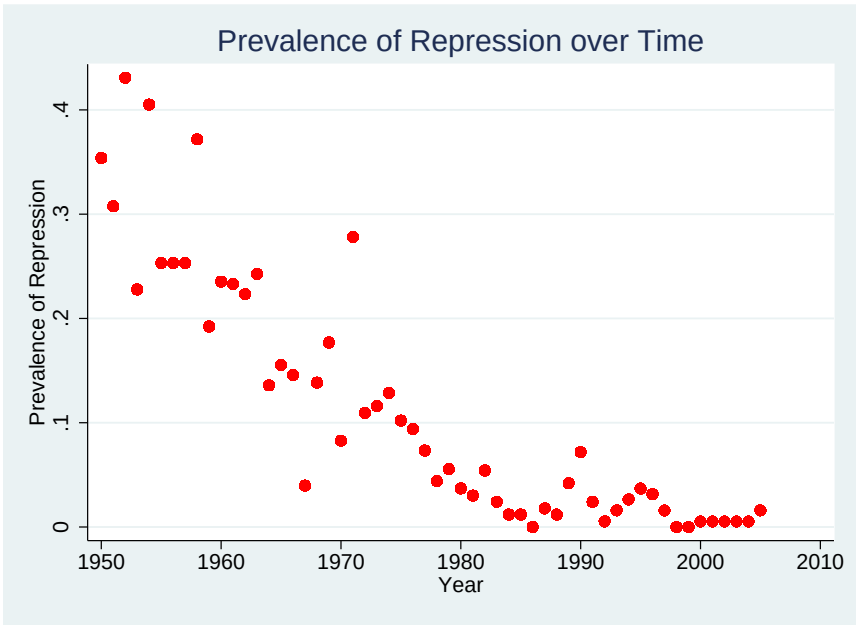
Figure 1.9 State capacity and executive constraints

Facts about violence – Figure 1.10

- Two-sided political violence – civil war:
  - prevalence varies greatly over years, peaks above 15% in early 1990s
  - prevalence varies greatly over countries, civil war and poverty (low GDP/capita) strongly correlated
  - two leading interpretations of 2nd fact:
    - ★ reflects low opportunity costs of fighting (Collier-Hoeffler, 2004),
    - ★ reflects low state capacity (Fearon-Laitin, 2003)
- One-sided political violence – repression:
  - many governments use violent means to raise their probability of staying in power without civil war breaking out
  - by strict measure, purges, about 8% of country-years since 1950
- Relation to civil war facts
  - purges have opposite trend to civil wars until early 1990s peaks among higher-income countries than civil war
  - hint of substitutability between the two







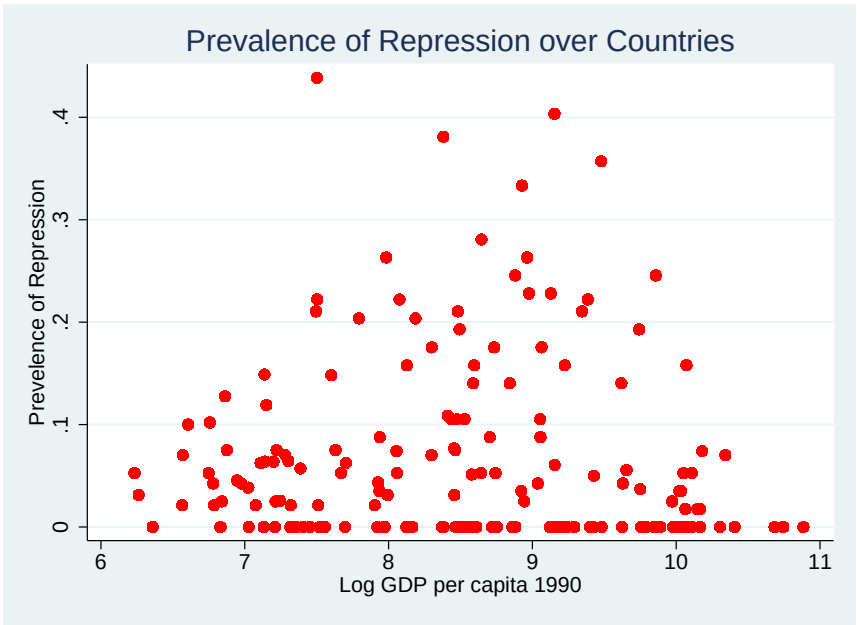
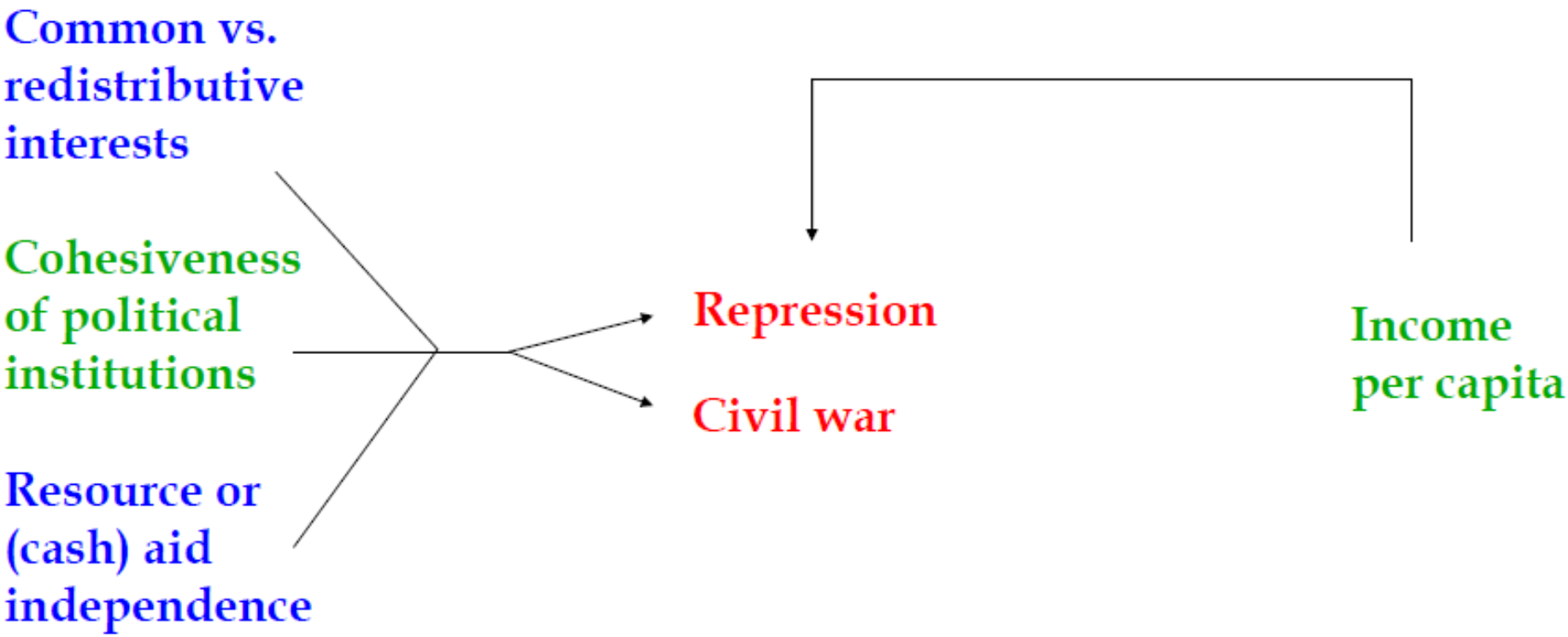


Figure 1.10 Prevalence of civil war and repression

Chapter 4 – Figure 1.11

- Add investments in political violence
  - solve for investments in violence by two groups
  - find analytical typology with three violence states
  - endogenize political (in)stability
  - uncover determinants of violence
- Long empirical detour
  - from theory to data
  - present econometric results

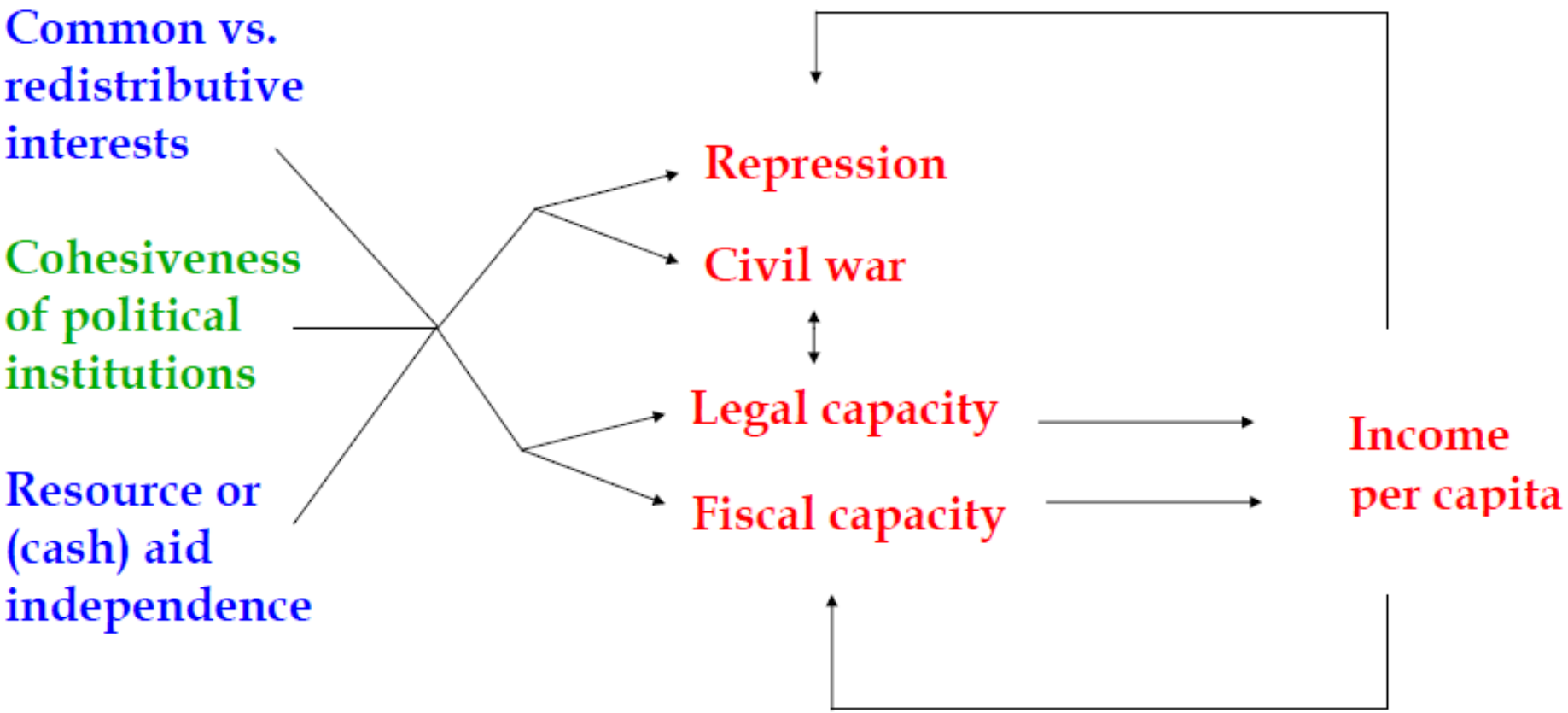
Figure 1.11 Scope of Chapter 4

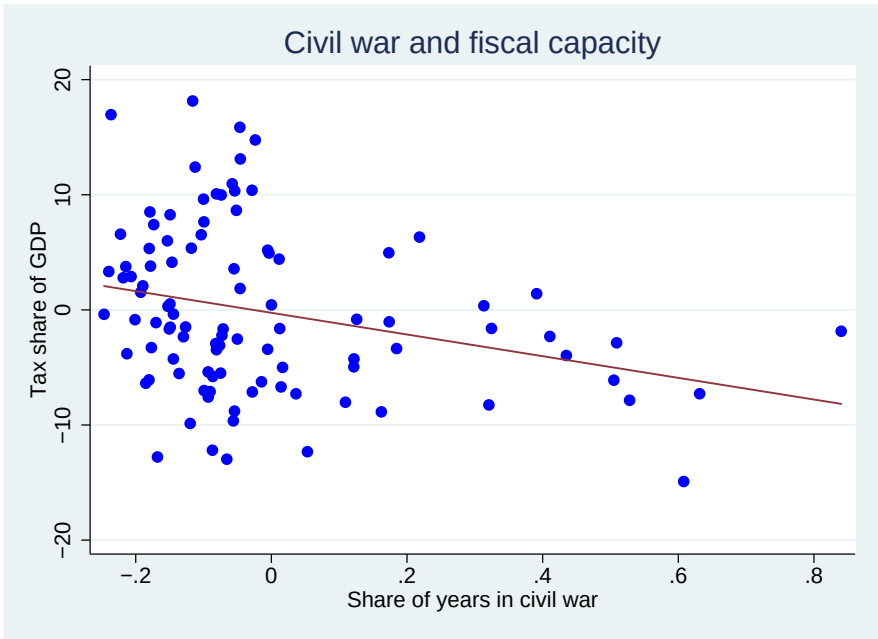


Chapter 5 – Figures 1.12, 1.14

- Putting pieces together
  - revisit investments in state capacity with endogenous political stability (turnover)
  - common determinants and feedback effects may cluster strong state capacities in rich peaceful societies, or vice versa
  - gives new perspectives on the data
  - partial correlation of state capacity and violence is consistent with theory – figure 1.13
- Summarize analysis that far
  - local and global comparative statics imply two-way, state-space matrix, and *Anna Karenina Principle of Development*

Figure 1.12 Scope of Chapter 5





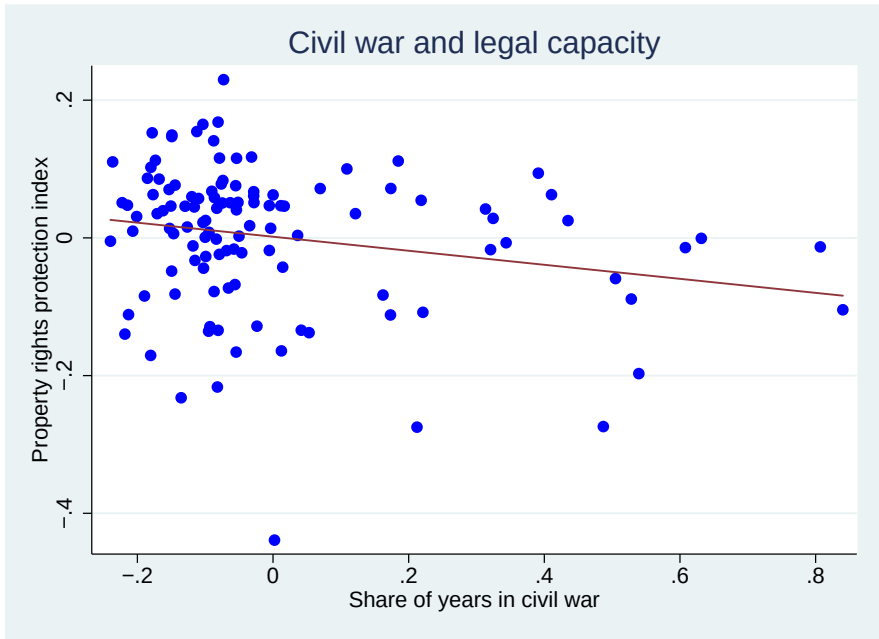


Figure 1.13 State capacity and civil war

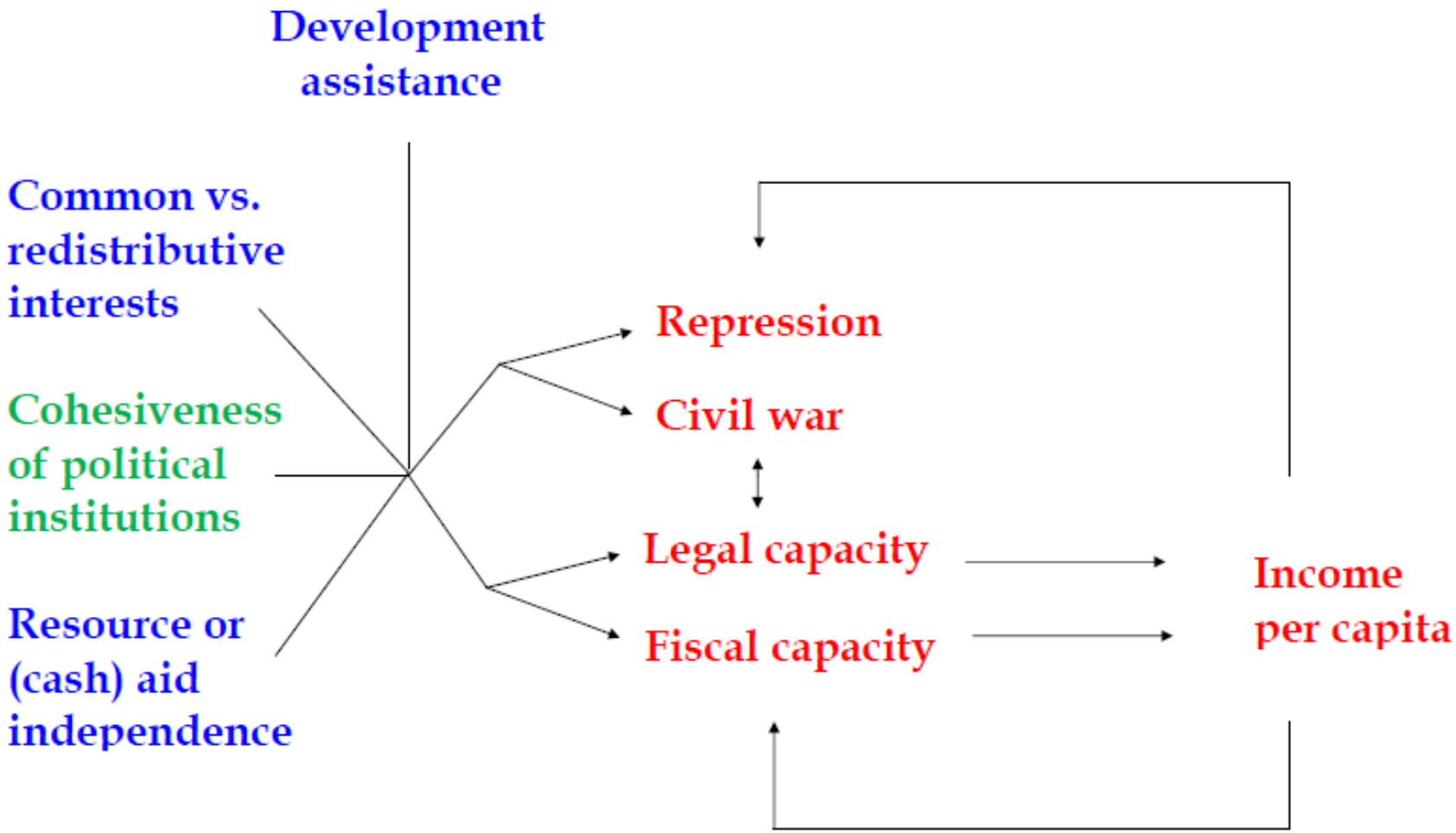
Figure 1.14 Our state space

	Weak	Redistributive	Common interest
Peace			
Repression			
Civil war			

Chapter 6 – Figure 1.15

- Discuss consequences of development assistance
  - use model framework to evaluate effects of different forms of assistance in different forms of states
  - cost-benefit analysis for donor, with endogenous responses of policy, state-capacity investment and violence
  - provide consistent perspective on outside interventions in weak or fragile states

Figure 1.15 Scope of Chapter 6



Chapter 7 – Figure 1.16

- Add possibility of political reform
  - cohesiveness of political institutions central determinant of investments in state capacity and violence
  - analyze incentives to reform these institutions
  - stability of strong (weak) and peaceful (violent) states? reforms away from and towards cohesiveness?
- Deepen and broaden the analysis
  - provide some microfoundations for cohesiveness and the rate of (peaceful) political turnover
  - additional implications for development assistance?

Figure 1.16 Scope of Chapter 7

