IS A STRONG STATE A PREREQUISITE OR AN OBSTACLE TO ECONOMIC GROWTH?

Ayushman Mukherjee

Queen Elizabeth's School, Barnet

John Locke Institute Essay Competition

July 2020

CONTENTS

1 INTRODUCTION

Sometime before 1989, a Soviet apparatchik in charge of bread production in St Petersburg asked the British economist Paul Seabright, “Who’s in charge of London’s bread supply?” To the surprise of the Soviet, Seabright replied, “Nobody.”

Indeed, there was no one to coordinate the bakers, machinists, electricity suppliers, or the distributors. What was performed by the central planning system of the Soviet Union, was performed by the market economy of the United Kingdom.

1.1 Defining Economic Growth

One of the founding fathers of economics, Alfred Marshall, famously advised, “Every short statement about economics is misleading.” Indeed, defining an economy, or economics for that matter, proves to be an onerous task. However, as Seabright’s conversation with the Soviet alluded to, we can define an economy in terms of its outcomes. It directs scarce resources towards the satisfaction of needs and wants – from the wheat fields of Bedfordshire, to the family dinner table in London.

From such a foundation, defining economic growth seems almost second-nature. If the economy controls the allocation of scarce resources for the production of goods and services; economic growth is the *increase in the total market value of final goods and services produced within a country’s border, in a given period of time.*

Over the years, economic growth has become the poster-child for a successful economy, because it most directly translates into higher per capita income and welfare. As the economy grows, businesses become more profitable, they pay employees higher wages and/or hire more employees, thereby reducing unemployment. Moreover, the government earns more from direct and indirect taxes, which it can then invest into infrastructure, social welfare, and education.

1.2 Red Herrings

It comes as no surprise to economists, that not all nations are equally prosperous. A British worker will earn more in a year than an Eritrean will in their entire career. Over the years, however, economists have attempted to apply facile explanations to what is, in essence, a deeply complex quandary.

Jeffrey Sachs has suggested that the root of growth disparity lies in geography. However, this would not explain the disparity between Nogales, Arizona and Nogales, Sonora. These two towns are but a few feet apart, and separated by nothing but a wall. Yet Nogales, Arizona is three times richer than Nogales, Sonora. The problem lies elsewhere.

What about culture? Max Weber suggested that some cultures were more productive than others. This, too, could not explain the difference between East and West Germany – two nations that shared a largely common culture.

British economist Lionel Robbins proposed that inequality existed because rulers didn't know how to make their country rich. Such an argument is equally inconclusive. Politicians, subject to the endless revolving door of lobbyists and special interest groups, usually undertake policies that enrich themselves, or keep themselves in power. It's not that they don't understand "good" economics – it's just that they simply aren't willing to pursue it because it isn't in their best interest. In the 1980s, the Chinese Premier Deng Xiaoping decisively defeated the hardliners of the Communist Party and subsequently launched progressive, free-market economic policies. He hadn't come across a sudden "revelation" on economic theory, rather, he was now able to secure his legacy without political impediment. Today, his legacy is that of an economic revolution.

Only in the 1950s would the Latin American Structuralist school suggest an alternative explanation: *the disparity of growth performance lies in the incentives created by political and economic institutions.*

1.3 The "Strong" State vs. the "Weak" State

There are 3 key criteria to differentiate the "strong" state from the "weak" state:

1. **Law and Order**
    - i) Does the state hold a monopoly of violence?
    - ii) Can it uphold property rights, civil disputes, and trademark laws?
    - iii) Can it collect tax efficiently?

2. Economic Interventionism

i) Is the state a command economy, where the government allocates investment, production, and capital goods?

3. Political Freedom

i) Is the state authoritarian, where political challengers are repressed?

ii) Is cronyism rampant?

iii) Are political freedoms curbed, such as freedom of speech?

Different nations satisfy different combinations of these criteria.

	USA	**PRC**	**DPRK**	**Somalia**	**Libya**
Efficient legal system?	Y	Y	Y		
Stringent intervention?			Y		Y
Authoritarian?		Y	Y	Y	

The strongest state would be one that held a monopoly of violence, led a centrally-planned economy, and repressed political impediment. Consequently, the weakest state would have little jurisdiction, would not intervene in the free market, and be entirely anarchical.

In the next chapter, we shall begin to ascertain which combination of these criteria maximize economic growth.

2 STRONG STATE CRITERIA

2.1 Law and Order

2.1.1 Weak Government

A weak government has legal inadequacy: it cannot enforce property rights nor uphold many of its laws. Such insufficient clarity results in interventions based on capricious executive direction – such as tax regimes with official discretion in assigning rates. This drives firms into the informal sector, deprives the government of tax revenues, and inhibits basic public goods such as law enforcement.

Reform measures, property rights, and contracts are not durable – and consequently, competitive markets cannot be sustained. Powerful private groups, colluding with the political regime, ultimately extract the nation's resources in a predatory manner.

2.1.2 Strong, Unlimited Government

A strong, unlimited state may satisfy the first criteria. However, lacking constitutionally defined limits, they are likely to be confiscatory. This makes it impossible to make a credible commitment to private-sector development, a quandary faced by Vietnam, Syria, Ethiopia, Iraq, and the former USSR. Instead, unlimited states must offer monopoly rights, preferential tariffs, or trade-union privileges. This creates political risk, and reduces FDI, thereby undermining the possibility of reform. Both the weak, and strong unlimited state are predators of private wealth.

2.1.3 Strong, Limited Government

The strong, limited state can uphold property rights, thereby satisfying the first criteria, but is also constitutionally prevented from violating such rights. It requires administrative structures that separate economic and political activities, thereby sustaining competitive markets but preventing attempts to monopolize marketplace access. Such a state is perfectly epitomized in British Hong Kong, where positive noninterventionism protected the market from pressure groups. Only by separating the political and economic functions of government, as seen in North American, Western Europe, Japan, Malaysia, Singapore, Taiwan, and South Korea, can property and contract rights be upheld.

2.1.4 Maxim

Our analysis has culminated in the maxim:

- A strong state that can uphold its laws and property rights is necessary, but not sufficient, for economic growth. It must be coupled with constitutional law that prevents the violation of such rights.

2.2 Economic Interventionism

Historical experience from Sparta and Athens down to modernity shows that a command economy performs better in the short run, particularly during wartime, whereas a market economy produced better long-term results. Marx and Mises notwithstanding, most nations are neither command nor market oriented. Most have applied a mixture of the two. Indeed, a mixed economy is most compatable with democracy. Let us begin to assess this system against three objectives: adequacy, sustainability, and equity.

2.2.1 Adequacy

An economy must provide an adequate quantity and assortment of goods and services, proportionate to the level of productive effort expended. Mixed economies address adequacy by relying on the familiar institutions of private ownership and resource allocation through the market process. It acknowledges the motivating power of self-interest, the information-handling facility of the free market, and power diffusion through decentralization of production decisions. These are unseen in the centrally planned command economy.

Adequacy also entails the provision of public goods: education, health care, transport, and security, which contribute to an adequate standard of living. These would be underprovided if left to the free market.

2.2.2 Sustainability

Sustainability (the temporal dimension to the concept of adequacy) addresses the long-run continuity of society, and can be threatened by economic crisis, ecological degradation, and political insecurity. The destructive extreme of the unfettered free market was seen in the 1930s – which brought the economic system to its knees. Keynesian fiscal and monetary intervention after the war minimized economic fluctuations and aimed to move toward a non-inflationary full employment.

Mixed economies are also swift to respond to alterations in the macroeconomic environment. Such flexibility is achieved through private responses to intermittent price fluctuations, supported by public sector intervention if needed. This enabled nations in the OECD to respond swiftly to the oil crises of the 1970s. Command economies can never achieve this level of flexibility, especially when dealing with crises that require international cooperation, such as that of rapid atmospheric alteration.

Mixed economies also enable long-term indicative economic planning by coordinating public and private policy decisions. It is a device for incorporating social values and community power into the future direction of society.

2.2.3 Equity

Under unfettered free markets, resources would be directed to the satisfaction of frivolous whims of those with grandiose affluence. The minimal adequacy for low income persons remains unmet. Reduction of income inequality results in rational use of resources, as the community is better able to satisfy the needs in order of their priority.

Reducing income inequality also upholds democracy and political equity – providing the opportunity to acquire better political access and legal representation.

Equally, a moral argument addresses that a significant portion of income inequality results from luck or fortune: one’s birth circumstances, and genetic endowment. Compensation for such consequences are morally unjustified.

2.2.4 Conclusion and Maxim

Unfettered capitalist economies demonstrate strong performance in output expansion and static productivity, but do not distinguish themselves with regard to economic stability or equity. Centrally planned command economies exhibit long-term stability and equity, but have been unimpressive with productivity growth, efficient resource use, and political and economic democracy. Consequently, a mixed economy is required:

- Mixed economies are best oriented towards sustained economic growth, by offering a pragmatic, rather than a rigid, approach to adequacy, sustainability, and equity

2.3 Political Freedom

2.3.1 Democratic Pluralism

As we ascertained, a strong state must be constitutionally bound to abide by limits on their power. This is upheld by the rejection of authoritarianism.

The desire to create strong but limited government is often balanced on the pretence of increasing executive discretionary power. Indeed, it was this pretence used during Hitler’s Machtergreifung and consequently by leaders in Russia and Latin America. Reform-minded leaders may implement a reform package by eliminating veto sources by executive decree, yet all such reform programs can also be undone by decree. In this respect, it is a two-edged sword.

For reform to be durable, it must be costly for politicians and leaders to renege on their promises. American federalists realized that altruism in public office cannot be dependable, as only godlike figures would place public good before those of their family and acquaintances. Incentives must be put in place to preserve the system - ensuring clear boundaries between private and public, thereby attracting FDI inflows with a long-term horizon to sustain growth. Stability requires normality, and normality requires consent.

Successful East Asian economies have institutionalized several limits on executive power:

1. **Channels of representation** for public and private sector institutions, such as deliberation councils. This minimizes behind-the-scenes favour seeking, as the exchange of views is transparent.
2. **Wealth sharing** via health services, education, and housing. This gains the cooperation of the citizenry, enabling the private sector to invest in fixed capital as the risks of unrest have been mitigated.
3. **Competent bureaucracy** with merit-based recruitment, competitive salaries, and the prospect of retirement to a board seat. Bureaucracies also uphold harsh penalties for corruption in order to improve the productivity of the civil service, thereby encouraging private-sector confidence.

2.3.2 Pluralism in Europe

To an ancient economist from 1500 years ago, it would appear that Europe would be the last possible place for a potential Industrial Revolution. China and the Arab world boasted far superior scientific and technological achievements, and India was endowed with enormous natural wealth and human skills. However, what would ultimately favour Western Europe was its weak aristocracy. Feudalism in Britain began to disintegrate after the 1381 Peasants' Revolt – as the elites did not have the pre-requisite organization or power to prohibit the encroachment by the proletariat. Democratic pluralism was ultimately solidified following the Glorious Revolution of 1688.

Across the rest of the world, incomes remained highly unequally distributed. In 1800s Manchu China, a population of 400 million supported two percent of the population which consumed a quarter of national output. In fact, the vast majority of the population in China, Mesopotamia, and India hovered slightly above levels of subsistence. Europe, on the other hand, had risen far beyond the threshold of survival as lower inequalities allowed for an environment that kept predation in check on behalf of organized groups and the state. By curtailing the power of the aristocracy, Europe had unwittingly created an economic environment and structure that encouraged productive investment and economic growth. Imperialism arose from rapid developments in techniques and weapons of warfare, and the European powers quickly began to colonize every corner of the world.

2.3.3 Maxim

Our analysis has culminated in the maxim:

- So long as law and order is upheld; a pluralist democracy that holds politicians accountable for reneging on their promises will encourage economic growth.

3 CONCLUSION

We have arrived at the conclusion that certain elements of strong states are pre-requisites to growth, whereas others pose obstacles. Namely, a state ought to be able to uphold its law and property rights, but this must be coupled with constitutional limits. This is usually installed by a pluralist democracy that holds politicians accountable for reneging on their promises. Equally, interventionist policies ought to be limited, but not nullified, in order to create a mixed economy that provides adequacy, sustainability, and equity.

4 APPENDICES