The Role of State Capacity in Economic Development

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“In 1960 the Philippines and South Korea had about the same standard of living as measured by their per-capita GDPs of about $640 U.S. 1975. The two countries were similar in many other respects… In both countries, all boys of primary school age were in school, and almost all girls, but only about one quarter of secondary school age children were in school. Only 5% of Koreans in their early 20s were in college, as compared to 15% in the Philippines. 26% of Philippine GDP was generated in agriculture, and 28% in industry. In Korea the comparable numbers were 37 and 20 percent.” - Lucas (1993, p. 251)

What happened next? We know the answer.

“I do not think it is in any way an exaggeration to refer to this continuing transformation of Korean society as a miracle. How did it happen? Why did it happen in Korea and Taiwan and not the Philippines?”

The explanation Lucas then provides for this remarkable economic divergence is based on differential patterns of learning-by-doing and human capital accumulation related to openness. Human capital certainly accumulated a lot faster in Korea, but from our perspective Lucas’ discussion of what was different about Korea and the Philippines in 1960 is very narrow. A huge unmentioned difference was that Korea was able to lay claim to a long history of centralized, bureaucratized state authority with a homogeneous national identity. The Philippines was not.

Though we often take for granted the existence of states with the capacity to enforce law and order, regulate economic activity, and provide public goods like human capital, many states in less-developed parts of the world lack this capacity. The idea that such state capacity is vital for economic development began to attract attention precisely as a consequence of analyses of the “East Asian Miracle” that puzzled Lucas. A series of books culminating in Evans (1995) argued that a key to the economic success of East Asian economies was that they all had states with a great deal of capacity. Others, such as Herbst (2000), linked the economic failure of African nations to their limited state capacity.

Though such arguments are plausible and consistent with a lot of historical and case-study evidence, there are large challenges to really pinpointing the role of state capacity in promoting economic development. State capacity is multi-dimensional: it involves the ability to establish a monopoly of violence, the ability to raise resources (fiscal capacity), and to implement policy (bureaucratic capacity). We have few theories of how these co-vary or are determined and they may obviously be influenced by development or by other factors, such as the nature of society (think of homogeneous Korea).

Thus there are problems of both reverse causality and endogeneity to be addressed before being able to say convincingly that state capacity does play a causal role in promoting economic development.

In Acemoglu, García-Jimeno, and Robinson (2014) we study the effect of state capacity of Colombian municipalities on public goods provision and development outcomes. We conceptualize “state capacity” as the presence of state functionaries and agencies. This represents a central aspect of what Mann (1986) calls the “infrastructural power” of the state. Colombia provides an ideal laboratory for such an investigation for several reasons. Figure 1 shows that there is a wide diversity of development and...
public good outcomes across Colombian municipalities. The left panel shows the distribution of the proportion of the population above the poverty line (from the 2005 census) while the right panel shows average secondary school enrollment over 1992-2002 (from the ministry of education). Both go from basically zero to 100%.

Figure 2 shows that there are strong positive correlations between the total number of public employees, one of our basic measures of state capacity, and both of these development outcomes. This and all subsequent figures partial out the effect of current municipal population on state capacity and development outcomes to look at state capacity and development outcomes not predicted by population.

But is Figure 2 indicative of a causal relationship? To address this, we develop an identification strategy based on the history of Colombian state formation. In particular, we focus on the historical presence of colonial state officials, colonial state agencies, and the colonial “royal roads” network. This network has disappeared and thus provides an attractive source of variation in the historical presence of the state and the cost of building and expanding local state capacity (especially when we control for distance to current roads). Figure 3 gives some sense of the “first stage” relationship between one of our historical measures of state presence and contemporary state capacity. It shows there is a positive correlation between the number of colonial state employees at the municipality level in 1794 and the same measure today. Since the state-building strategy of the colonial authorities was quite unrelated to subsequent republican state-building aims, this historical data creates an attractive source of variation.

Yet reverse causality and omitted variables biases are not the only chal-
**Challenges to estimating the impact of state capacity on development.** This is because state capacity in one municipality likely has impacts on public goods provision and economic outcomes in neighboring municipalities. We expect (and empirically find) such neighborhood spillovers to be important. To illustrate this, Figure 4 shows the relationship between the same two development outcomes we examined in Figures 1 and 2 and the average of the state capacity of neighboring municipalities. These are strongly related.

These cross-municipality effects imply that building state capacity is a strategic choice for each municipality. If municipalities free-ride on their neighbors’ investments, state capacity choices will be strategic substitutes. Conversely, if municipalities find it harder or less beneficial to build state capacity when it is missing in their neighborhood, they will be strategic complements. We incorporate these strategic aspects by modeling the building of state capacity as a network game. We then estimate the parameters of this model, exploiting both the network structure and the exogenous sources of variation discussed above.

Our benchmark estimates imply, for example, that moving all municipalities below median state capacity to the median will have a “partial equilibrium” direct effect (holding the level of state capacity of all municipalities above the median constant) of reducing the median poverty rate by 3 percentage points, increasing the median coverage rate of public utilities (electricity, aqueduct, and sewage) by 4 percentage points, and increasing the median secondary school enrollment rate by 3 percentage points. About 57% of these impacts is due to a direct effect, while 43% is due to network spillovers. The “full equilibrium” effect is very different, however. Once we take into account the equilibrium responses to the initial changes in local state capacity in the network, median coverage rate of public utilities increases 10 percentage points, the median fraction of the population in poverty falls by 11 percentage points, and median secondary school enrollment rates increase by over 26 percentage points. These large impacts, which are entirely due to network effects, highlight not only the central role that state capacity plays in economic development but also the importance of taking the full equilibrium effects into account.

All in all our results suggest that there are powerful causal effects of state capacity on economic development.

**References**


