



# **The Challenge of 21st century Development: Building Capability- Enhancing States**

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## Acknowledgments

'Capacity *is* Development' is a call to systematically review, capture and discuss key capacity development lessons of the past and to look on to the future. Through distilling key policy and investment choices made over time to motivate forward planning on capacity development, this research paper helped define the content framework of the 'Capacity *is* Development' Global Event. This paper was written by Peter B. Evans. Special mention is made of contributions by Hugh Roberts, Bill Tod, Degol Hailu, Jamshed Kazi, Niloy Banerjee and Tsegaye Lemma.

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# The Challenge of 21st century Development: Building Capability-Enhancing States

## I. Introduction

Developmental success will elude any country that lacks state capacity. Neither theorists of development nor practicing policy-makers contest this general proposition. Having agreed, they must face the challenge of specifying what kind of “capacity” is necessary and how it might be constructed. My aim here is to explore what seems to be the most promising form of state capacity – the “capability-expanding” state – drawing on modern development theory and the historical trajectory of development in the late 20<sup>th</sup> and early 21<sup>st</sup> century.<sup>1</sup>

My starting premise is that the 21<sup>st</sup> century state must be, explicitly and self-consciously, a “capability-expanding state” if it is to be a “developmental state.” Amartya Sen (1999:18) argues that we should evaluate development in terms of “the expansion of the ‘capabilities’ of people to lead the kind of lives they value – and have reason to value.” “Well-being” involves more than increasing contentment or reducing suffering; it involves the capacity of human beings to do the things that they want to do. Thinking in terms of “capabilities” rather than just “well-being” draws our attention to the fact that human capabilities are both ends in themselves and key means to the intermediary goals that help us to “lead the kind of lives we value,” intermediate goals such as economic growth and the construction of democratic institutions.<sup>2</sup>

Sen’s focus on well-being as the active exercise of capabilities dovetails perfectly with the insights of the “new growth theory,” which make it clear how fundamentally a society’s ability to produce the goods and services it needs and wants depends, above all, on the exercise of the “human capabilities” of its people.<sup>3</sup> Putting the “new growth theory” together with a focus on human capabilities leads directly to a new emphasis on the role of the state. Building state capacity also becomes more challenging in this optic. Both the internal organizational requisites of increased capacity and the state-society relations required for effective capacity are more demanding.

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<sup>1</sup> For an earlier, more elaborate version of my argument, focused more specifically on the South African case, see Evans, 2010.

<sup>2</sup> While pioneered theoretically by Amartya Sen (1981; 1995; 1999a; 1999b; 2001), the “capability approach” has been instantiated as policy-relevant analysis through two decades of work centered around the UNDP’s Human Development Report. See, for example, Mahbub Ul Haq (1995).

<sup>3</sup> The “new growth theory” as put forward by theorists like Lucas (1988) and Romer (1986; 1990; 1993a; 1993b; 1994) built on early work by Solow (1956) and has been subsequently developed by a range of economists like Aghion (Aghion and Howitt 1998) and Helpman (2004). See discussion below.



Before returning to the implications of the intersection of the capability approach and the new growth theory, it makes sense to review what we have learned from 20<sup>th</sup> century developmental states. There is much of value to be learned, as long as we don't slip into the illusion that the experiences of these states constitute a "ready to wear" model that will resolve the current problems of state capacity.

### **What lessons from the 20<sup>th</sup> Century developmental states?**

Studies of the archetypal 20<sup>th</sup> century developmental states, Korea and Taiwan, agreed overwhelmingly that the state was one of the institutional keystones of their remarkable success.<sup>4</sup> Since moving from agriculture to manufacturing was considered the heart of the development project, these analyses focus primarily on the state's role in facilitating industrial transformation. The capacities exhibited in these successful cases of industrial transformation have been well-specified, with the coherence and quality of the bureaucratic apparatus taking pride of place along with the ability to create dense ties to industrial elites.

Nearly everyone agrees that when East Asian public bureaucracies are compared with those of developing countries in other regions they more closely approximate the ideal typical bureaucracy. Meritocratic recruitment to public service and public service careers offering long-term rewards commensurate with those obtainable in the private sector were institutional cornerstones of the East Asian economic miracle. Meritocratic recruitment was important, not only to promote competence but to give state employees a sense of *esprit de corps* and belief in the worthiness of their profession. Long term career rewards based on performance kept competent individuals from deserting public service.<sup>5</sup>

While the effects of bureaucratic capacity are most evident in the East Asian NICs, the positive developmental effects of competent cohesive bureaucracies go beyond this set of countries. A simple analysis of cross-national data from a larger set of countries confirms the importance of bureaucratic capacity (Evans and Rauch 1999, Rauch and Evans, 2000). In this sample of developing countries, the results from investments in improving bureaucratic capacity were large. Roughly speaking, an increase of one half of a standard deviation in the indicator of bureaucratic capacity is worth a 26 percent increase in GDP from 1970 to 1990 (controlling for human capital and initial GDP per capita). Likewise, an increase of one standard deviation in this indicator is roughly equivalent to a shift in average years of education in 1965 from 3 years to 6 years (controlling for initial GDP per capita).

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<sup>4</sup> See, for example, those by Amsden (1989), Wade (1990) and myself (1995) and more recently by Vivek Chibber (2003) and Atul Kohli (2004). Or even the World Bank (1993; 1997).

<sup>5</sup> This is not, of course, to say that "corruption" was absent from these cases of successful industrial transformation.



Coherent, competent public bureaucracies were essential to East Asia's developmental success, but not sufficient. These were capitalist societies. Private actors made most of the business decisions crucial to industrial transformation. If state bureaucracies had remained disconnected from industrial elites they would have been ill-informed and ineffectual. Developmental states were "embedded" in a dense set of concrete social ties, formal and informal, that systematically connected state bureaucracies with private entrepreneurs and industrial associations (Evans, 1995:12). Without these ties, state bureaucracies would not have known what projects were feasible or how much risk they could coax private capital to take. Embeddedness provided key intelligence and facilitated implementation. Connecting a coherent state bureaucracy to the industrial elite facilitated the collective organization of these elites, making it easier for them to participate coherently in shared projects of industrial transformation.

Competent, coherent public bureaucracies and dense ties to industrial elites enabled industrial transformation in 20<sup>th</sup> century developmental states, but there are other lessons to be drawn from these states as well. Fascination with industrialization has distracted attention from the centrality of capability expansion in the success of the East Asian tigers. In fact, they were pioneers in capability expansion, renowned for their levels of investment in human capital. They began their periods of accelerated economic growth with education levels that made them outliers for countries at their income levels and continued to invest massively in the expansion of education throughout the period of their rapid expansion. Over time, they became even more involved in capability expansion, building, for example, more comprehensive systems for the provision of health care (see Wong, 2004).

20<sup>th</sup> century developmental states offer valuable lessons to 21<sup>st</sup> century capacity-builders, but would-be emulators must take note of the unusual geo-political circumstances that helped nurture the "East Asian miracles." Post World War II East Asia was orphaned by transnational capital -- too poor, too alien and too politically risky to be an interesting investment site. Local capitalist classes were weak. The regional colonial power -- Japan -- had just been crushed. The global hegemony -- the United States -- was more worried about the threat of communism in Asia than expanding the role of American firms in countries like Korea and Taiwan. The international political economy currently faced by the Global South is quite different. Trying to transfer lessons to contemporary developing countries without considering the changed context would be foolish.

### **The 21<sup>st</sup> Century Development Context:**

Both the global economy and our theoretical perspectives on the goals and means of development have shifted over the four decades since the advent of the 20<sup>th</sup> century developmental state. New visions of state capacity must reflect changed context, changed theoretical understandings and newly salient goals. Theoretical shifts have already been flagged



but are worth reviewing. New theoretical understandings highlight pivotal political and economic shifts that capacity-builders must confront.

The theoretical argument and empirical evidence put forward by new growth theorists made the case that creating and utilizing new ideas was more important to 20<sup>th</sup> growth than the accumulation of plant and equipment and other tangible capital.<sup>6</sup> If this was true in the 20<sup>th</sup> century, ideas and “human capital” are even more central to 21<sup>st</sup> century growth. 21<sup>st</sup> century value creation is becoming increasingly “bit-driven” in the sense that value added comes new from new ways of arranging bits of information in formulas, software code, and images and less from the physical manipulation of materials to make tangible goods.<sup>7</sup> The global corporations that control patents, formulas or recognized retail brands squeeze the margins of manufacturers of generic goods unmercifully. Local manufacturers in turn squeeze their workers while adopting evermore labor-saving production technologies, regardless of local wage levels. The link between the expansion of manufacturing output and employment growth has shifted accordingly. In 21<sup>st</sup> century, job growth has moved to the service sector. Already in the late 20<sup>th</sup> century, the total number of manufacturing jobs was shrinking in both North and South. Even in China, the new “workshop of the world,” the official tally of manufacturing jobs was shrinking rather than growing by the end of the 20<sup>th</sup> century (see Evans and Staveteig, 2009). Manufacturing, traditionally considered the sector where good jobs grew, was no longer capable of playing the same role. Manufacturing remains a central element in any developing economy, just as agriculture does, but it is no longer the principle font of employment or increased well-being.

The new centrality of services forces any state that wants to be “developmental” to focus more intensely on people and their skills instead of machines and their owners. It also brings us back to the issue of capability expansion. Some parts of the service sector take direct credit for generating high levels of value-added. Unfortunately, they employ relatively few people. Large segments of the service sector create the “human capital” that is the foundation for increased productivity. Unfortunately, these jobs are under-appreciated and under-rewarded.

Privileged workers in the business and financial services sectors and the “symbolic analysts”<sup>8</sup> who manipulate key information in other sectors enjoy a comfortable share of the returns from “bit-driven” growth. Their capabilities play an obvious and direct role in generating value and growth. The service sector is also the site of capability expansion. Jobs involved in the nurturance and sustaining of general human capabilities, building the foundations necessary for capabilities of all kinds are numerous and badly under-remunerated. If the expansion of human capabilities is both the key means and central goal of development, then rewarding capability-

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<sup>6</sup> For recent summaries see Aghion and Howitt (1998); Easterly (2001: Chapters 3, 8, 9); Helpman, 2004.

<sup>7</sup> Cf. Negroponte (1996).

<sup>8</sup> The term is Robert Reich’s (1991).



expanding services and increasing their supply should be a developmental priority. Yet, in practice, capability-expanding services like health and education are under-supplied as well as being under-rewarded.

This is hardly a paradox from the perspective of market logic. Since social returns to the expansion of human capabilities are substantially higher than private returns, private markets consistently and perennially underinvest in human capabilities. Private investors will underinvest in “human capital” because they cannot control the human beings in whom it is embodied in the way that they can dictate how machines and buildings are used. Instead, markets channel investment to other areas where total returns may be lower but private returns appear higher. This is particularly true in the case of the most fundamental capability-expanding services. The best example is early childhood education, where the capabilities generated will eventually have large impact on productivity, but only in the distant future. In sum, markets will chronically fail to supply optimal levels of the “human capital” crucial to bit-driven growth.

State capacity is the bridge between market rationality and the demands of 21<sup>st</sup> century development. When the 20<sup>th</sup> century state focused on industrial transformation, the search for private profits complemented state capacity. Once capability expansion becomes the core of the development agenda, private capital is no longer a dependable ally. Given the disjunctions between private and social returns, States may induce industrialists to venture into branches of production with higher value-added and more dynamically expanding markets by increasing incentives and reducing risks. Delivering capability-expanding services is likely to require the actual provision of organization and physical infrastructure. The necessity of more direct involvement implies apparatuses even more coherently competent than those that facilitated industrial transformation.

The difficulty of engaging private capital in joint projects of capability expansion has even stronger implications for embeddedness than for the internal dimensions of state capacity. Given the disjunction between private and social returns, capital may actually be hostile to devoting state resources to capability expansion, especially if projects are designed in response to community preferences rather than narrowly focused on job skills. In this case, dense, robust ties to private elites may become channels for the pursuit of private agendas that undercut the state’s ability to expand capabilities. Old forms of embeddedness may impede rather than facilitating effective state action.

The disjunction between developmental goals and the agendas of private capital is more acute in the Global South than in the North. Not surprisingly, northern corporate prefer to locate the “human capital” strategic to their profits in the North. Conversely, the long run effect of building effective “capability-expanding states” in the Global South would facilitate an eventual challenge to



current Northern monopolies on profitable knowledge, not a prospect likely to generate the enthusiasm of global capital (see Evans, 2005a).

Unfortunately, the increased unreliability of private capital has been accompanied by a simultaneous rise in the power of capital *vis a vis* the state, making the construction of state capacity more politically difficult. While the late 20<sup>th</sup> century saw theorists and policy makers recognize the vital role of state capacity, it also saw politicians and ideologues resuscitate older tropes of state power as the enemy of development. Curiously, while classic “liberal” attacks on the power of the state were directed primarily toward arbitrary authoritarian practices, the likely objects of more recent “neo-liberal” attacks was democratic state capacity aimed at inclusion. The new political and ideological climate, fostered above all by the United States in its role as global hegemon, reflected and reinforced the power of those corporations able to operate in a global arena where there was no unified sovereign power to check them.

If the lesson of the 20<sup>th</sup> century state is that capacity depends on a complementary combination of competent, coherent public bureaucracy and dense sets of systematic ties to relevant civil society actors, then building state capacity has become a more challenging task in the 21<sup>st</sup> century. Diminished complementarity between developmental goals and the interests of private capital raises the level of state capacity required. Growing imbalance between the power of capital and the power of would-be developmental states raises new political barriers to increasing state capacity. In short, the new 21<sup>st</sup> century context makes the “embeddedness” strategies of 20<sup>th</sup> century developmental states obsolete and forces rethinking the political foundations of 21<sup>st</sup> century state capacity.

### **Capability-Expanding State Capacity:**

The dual role of capability expansion as both goal and driver of development has become more obvious in the theoretical and historical context of 21<sup>st</sup> development. Despite the political difficulties of implementing capability-expanding strategies, the fact that the primary obstacles are organizational and political, not material scarcity is a powerful attraction. A project of capability-expansion draws on the resource that is most abundant in the Global South – people. It is the most labor intensive of any possible development project, and at least some portion of the required skills are widely distributed social and care-giving skills.

Capability-expanding state capacity is above all a political construction. In Sen’s framework, developmental goals cannot be defined in the absence of participatory, deliberative institutions that enable public interchange of ideas. Once again goals and means come together. On the one hand democratic participation offers the opportunity to exercise one of the most important of all





human capabilities: the ability to choose and is therefore an end in itself.<sup>9</sup> On the other hand democratic deliberation is the only effective means of organizing the pursuit of other developmental goals.

Broad based participation does more than define goals. Implementation of capability-expansion also depends on participation. As Ostrom (1996) has emphasized, capability enhancing services are always co-produced by the “clients.” They don’t just “receive” education. They use the infrastructure and inputs provided by the state to produce their education. Likewise health services can’t produce healthy people, they can only provide the infrastructure and information that will enable people to “co-produce” their own health. Without active engagement of individual recipients, families and communities as well service provision cannot achieve its ends. Treating the citizenry as passive recipients will produce sub-optimal or even counter-productive results.

This brings us back to “embeddedness.” Embeddedness is as important to the capability-expanding state as it was for the 20<sup>th</sup> century developmental state: as a source of information and to ensure that chosen strategies of implementation are feasible. The need for information and engagement with societal partners is even greater for the capability-expanding state.<sup>10</sup> Capability expansion is a more complicated task and the potential contributions of allies in society are more varied and socially dispersed. Even though health, education and other capability-expanding services are classic parts of the state’s role, they are more complex “products” than steel or computer chips. Trying to figure out how to “co-produce” capability expansion in a way that will efficiently serve the “co-producers” needs is enough to make any state bureaucracy nostalgic for the days when its principal challenge was industrial transformation.

The set of dense, systemic ties necessary to create the required embeddedness is correspondingly difficult to construct. A small set of elites sharing similar class backgrounds and analogous training won’t do it. Information on preferences and possibilities for implementation must be gathered from constituencies more numerous, more variegated and less organized than those that were involved in industrial transformation. Evaluating outcomes cannot be done simply via technocratic measures analogous to rate of return on investment or projected market share. Whether a project is worthwhile depends on how well its results correspond to the collective preferences of the communities being served.

Accurate information on collective priorities at the community level is the *sine qua non* of a successful capability-expanding state. Without multiple sources of information and plentiful opportunities for public deliberation, state agencies will end up investing inefficiently and wasting

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<sup>9</sup> As Sen (1999: 291) explains it, “processes of participation have to be understood as constitutive parts of the *ends* of development in themselves.”

<sup>10</sup> For an earlier elaboration of the concept of “encompassing” embeddedness, see Evans (1995: chapter 10).



precious public resources. Deliberative institutions become key contributors to efficiency as well as building blocks for democratic politics, the foundation of efficient development strategy and effective public policy (see Evans, 2004).

To create effective state-society linkages, the state must facilitate the organization of counterparts in “civil society.” Just as 20<sup>th</sup> century development states helped turn industrial elites into a more coherent class, a capability-expanding state must do the same for a broad cross-section of society. Embeddedness must enable communities to construct coherent shared goals whose concrete implementation can then be “co-produced” by public agencies and the communities themselves. It won’t be easy. “Civil society” is rife with individuals and organizations claiming to represent the general interest and full of conflicting particular interests in practice. Shared interests in capability expansion are broad and deep but articulating them is a politically demanding task.

New forms of embeddedness imply new forms of bureaucratic competence and coherence. The standard practices of bureaucratic apparatuses fit poorly with processes of community decision-making. As Sen (1999: 291) puts it, “a democratic search for agreement or a consensus can be extremely messy and many technocrats are sufficiently disgusted by its messiness to pine for some wonderful formula that would simply give us ready-made weights that are ‘just right.’” In a deliberative, co-production system of goal setting and service delivery, technocrats have no monopoly on valued expertise. Downward accountability and diminished status differentials between state officials and their clients/constituents are also part of the package. It is not a package that fits the preferences usually imputed to public servants.

Those who are trying to build a capability-expanding state must understand the reluctance of bureaucrats to move toward a more deliberative and encompassing embeddedness without assuming that resistance is insurmountable. It would have been easy to argue that the traditions of Asian bureaucracies would make it impossible to develop the networks and consultative practices necessary for successful industrial transformation. Willingness of traditionally trained Asian bureaucrats to adapt depended in part on their conviction that regime survival (and therefore the future of the bureaucracy itself) might depend on the success of the industrialization project. The position of state apparatuses in most of the contemporary global south is no less precarious today. Market solutions may have lost their sheen, but state bureaucracies are no less under attack. The fortunes of local capitalist are increasingly entwined with global schemes and alliances, diminishing their dependence on local state apparatuses. With a few exceptions, any given state in the global south is expendable from the point of view of transnational capital.

Local communities depend on the state for their well-being but state apparatuses can’t expect passive tolerance of ineffectual results. Even if institutions of deliberative democracy are not well-developed, popular antipathy toward state failure is still a powerful force. States that cannot organize the delivery of capability-expanding services will be judged failures: first of all for not securing the well-being of their people, but also for not being able to create new foundations for



economic growth. The obvious centrality of state action to capability expansion makes it hard to shift the blame for failure. Failure to industrialize might be the fault of timid local entrepreneurs or the malevolence foreign capital, but it is hard for states to escape responsibility for the inability to organize the effective delivery of capability-expanding services like health and education.

The tasks are demanding but there are many examples of positive results. The success and spread of “participatory budgeting” is one such example.<sup>11</sup> Farsighted bureaucrats and, even more crucially, the political leadership that stands behind them, should see building state capacity as a survival strategy and see a more encompassing embeddedness as the keystone to the construction of capacity.

### **The Challenge of Building Capability-expanding State Capacity:**

The argument for building capability-expanding state capacity is straight forward but worth reiterating. Without effective, aggressive action by entrepreneurial public institutions, citizens of the South will be unable to realize their potential productivity and enjoy the levels of well-being that the 21st century economy is capable of providing. Conceptualized of as the expansion of human capabilities, human well-being becomes both goal and driver of development. 20<sup>th</sup> century developmental states brought state capacity to the forefront of developmental debates. A focus on capability expansion ensures that it will stay there.

Like the 20<sup>th</sup> century developmental state, the capability-expanding state depends on a combination of coherent internal competence and external embeddedness, but the configuration required is quite different. Embeddedness takes the form of broad based connections between state and civil society channeled, at least in part, via deliberative institutions. This is the only way to ensure the flows of information necessary to guide the allocation of public resources and the “co-production” necessary for the effective implementation of capability-expanding services. Structures designed to promote bureaucratic competence and coherence within the state must be consistent with the structure of embeddedness.

Transforming “actually existing states” into capability-expanding states is a daunting task, but the potential returns are huge. Unless contemporary development theory is completely misguided, success in implementing these institutional transformations will be rewarded with more productive and dynamic economies. Most important, their citizens will have a greater chance of “leading the kind of lives they value – and have reason to value.”

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<sup>11</sup> See Baiocchi, 2005; Baiocchi, Heller and Kunrath, 2008.



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