The New Development Triangle: State Capacity, Institutional Foundation and Economic Policy

In the shaping of economic performance and development, the state is the most powerful and critical player. Through political decisions, the state has the capacity to influence allocation of production factors as well as formation of institutions. Within a state, there are also two main channels through which the state can shape economic performance—the state’s institutional system can shape the economic performance in the long run, and its economic (or social/political) policies can have influence in the short run. Together, state capacity, the institutional system and economic policy form the “New Development Triangle (NDT)”. Professor Tang Shiping from the School of International Relations and Public Affairs, Fudan University, explained this theory and how it can help to understand the conditions of economic growth.

Professor Tang divided the process of economic development into four phases: jump-starting, sustaining via imitation, basic innovations as economy moves up, and innovation at the frontier. By innovation, Professor Tang was referring to institutional instead of technological innovation, as technological innovation is an outcome underpinned by sound institutions and policies. The four different phases require the state to have different state capacities, institutions and policies, or the NDT. In this sense, NDT is a dynamic and evolutionary framework for understanding economic development.

Looking specifically at institutional system, there have been views that a democratic system is necessary for economic growth. Professor Tang’s statistical analysis, however, showed that the contribution of democracy can vary in different phases of development. When economies are in the catching-up stages (jump-starting and sustaining via imitation), a democratic system may not necessarily be helping a state to develop; as economies develop further to the innovation stages, democracy can be helpful and necessary.

A possible explanation could be that democracy protects liberty and creates greater room for peaceful bottom-up institutional change and the maturing of a sound institutional system, which eventually promotes growth. Professor Tang’s theory hence shows that democracy holds a positive but indirect effect upon growth, and is conditioned by the level of economic development.

In a broader sense, the institutional foundation of economic growth is a system in which many institutional arrangements are interconnected and embedded. This implies that there may be different combinations of specific institutions that can support robust economic growth. Therefore, Professor Tang argued that there is no perfect institutional foundation of economic growth, only better ones.

There is however weakness in solely looking at the institutional foundation of economic growth. The institutional foundation is endogenous rather than exogenous, and institutions alone cannot account for growth. To meet this challenge, Professor Tang suggested looking at the other factors in the NDT. Overall, he saw state capacity as more fundamental than institutional foundation and policies. Without a decent level of state capacity, institutions would not function well and policies would not be properly implemented.

This summary reflects the personal opinion(s) of the seminar speaker(s) and should in no way be attributed to the East Asian Institute.