We develop a principal-agent model to study fiscal capacity in pre-modern China and Japan. Before 1850, both nations were ruled by stable dictators who relied on bureaucrats to govern their domains. We hypothesize that agency problems increase with the geographic size of a domain. In a large domain, the ruler's inability to closely monitor bureaucrats creates opportunities for the bureaucrats to exploit taxpayers. To prevent overexploitation, the ruler has to keep taxes low and government small. Our dynamic model shows that while economic expansion improves the ruler's finances in a small domain, it could lead to lower tax revenues in a large domain as it exacerbates bureaucratic expropriation. To test these implications, we assemble comparable quantitative data from primary and secondary sources. We find that the state taxed less and provided fewer local public goods per capita in China than in Japan. Furthermore, while the Tokugawa shogunate's tax revenue grew in tandem with demographic trends, Qing China underwent fiscal contraction after 1750 despite demographic expansion. We conjecture that a greater state capacity might have prepared Japan better for the arrival of the West after 1850.