



The Political Economy of Inclusive Growth

OECD-WB Conference on Challenges and policies for promoting inclusive growth



24-25 March 2011, Paris

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Initial Observations

- Formal institutions work very differently in developing countries compared to advanced countries, and differently across developing countries
- Informal institutions and informal enforcement are far more important in developing countries
- Politics is personalized and based on coalitions of informal 'patron-client' political organizations using organizational power to allocate 'rents'



Governance challenges for inclusive growth

- In general governance improvements have been difficult to achieve in developing countries despite very significant reform programmes
- Improvements in political inclusion and success in inclusive growth are not necessarily the same thing in these contexts
- Significant differences in institutional structures across successful developing countries means there are no simple blueprints



Little disagreement about general principles

- Broad-based employment and wage growth in developing countries is constrained by different types of market failures
- Institutions and governance capabilities are important for addressing these
- There are many market failures but case studies point to the importance of failures in technology acquisition and land markets
- But which institutions and governance capabilities should we build?



Broad-based versus Targeted Governance Reforms

- Broad-based (market-enhancing) reforms attempt improve the enforcement of property rights and a rule of law so that market failures become less serious across the board
- But poor supporting evidence linking these reforms with growth and poor results of reform strategies attempting improvements in ‘good governance’ in developing countries
- Successful countries appear to have focused capabilities rather than ‘good governance’



Formal Institutions and Enforcement

- Institutional analysis coming from advanced countries weak on the analysis of enforcement
- Formal institutions imply distributions of benefits – they can be enforced only if the ‘holding power’ of beneficiaries is ‘aligned’ with this distribution of benefits
- This is generally the case in advanced countries because holding power is strongly linked to formal rights and incomes coming from the enforcement of formal rights



Informal sources of power in developing countries

- Developing countries are in a process of transition from traditional societies and large sections of their economies and politics remain in the ‘informal sector’
- Significant holding power is based in the informal sector
 - ❖ The ability to mobilize and finance politics often uses sources not yet linked to formal rights
 - ❖ The rents sought are also often outside the formal sector as the formal budget is small



Political Settlements and Social Orders

- Growing recognition that the ‘social order’ in developing countries is substantially different
- The ‘political settlement’ defines a social order as a macro-political equilibrium between institutions and the distribution of power across organizations that is reproducible over time
- If powerful organizations cannot get satisfaction through the enforcement of formal rules, informal organizations or the informal adjustment of formal institutions is the result

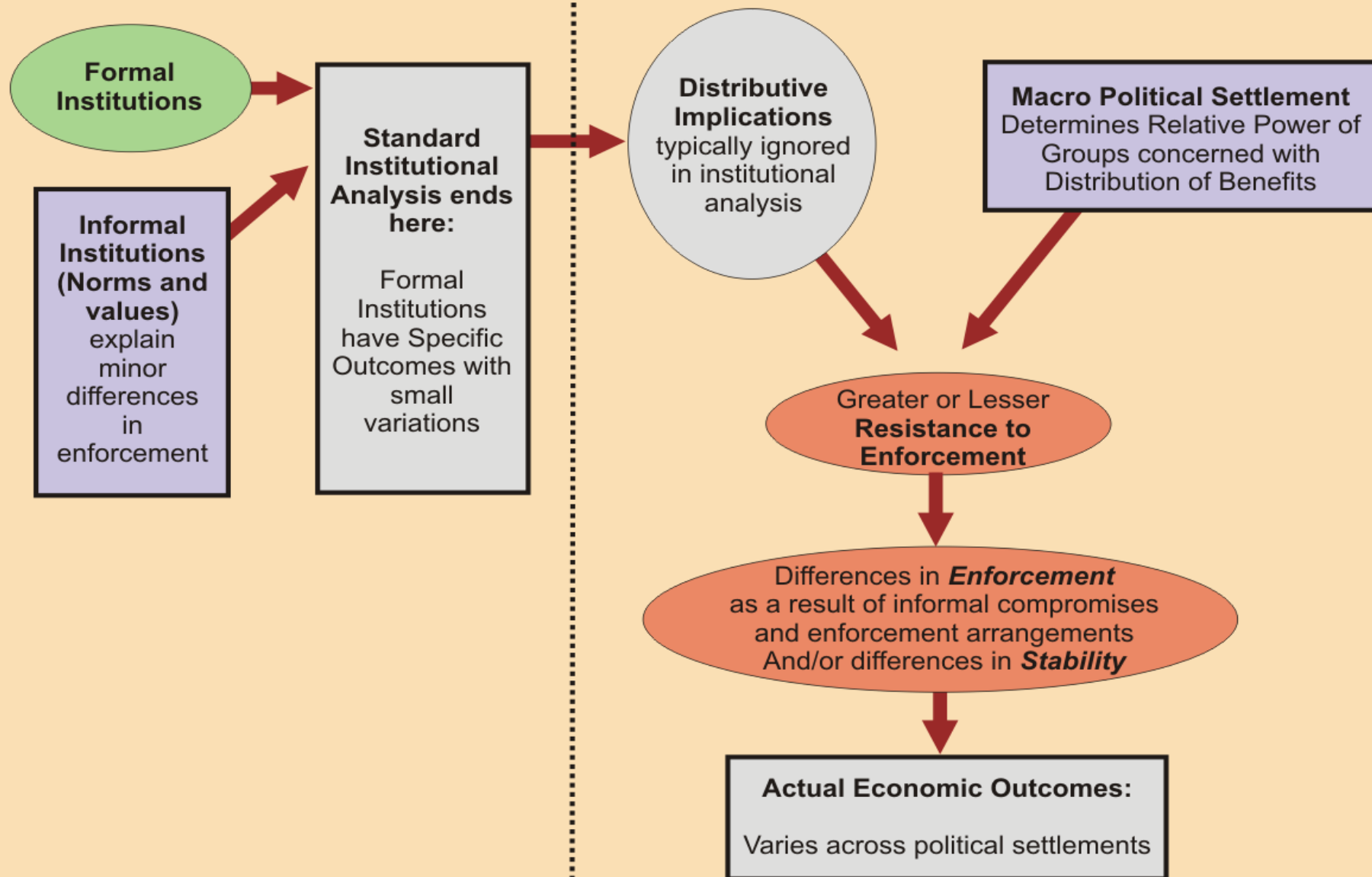


Informal Institutions and the Political Settlement

- Informal arrangements change the distribution of benefits till an equilibrium is achieved between institutions and power
- The political settlement in developing countries therefore has significant informal institutions and arrangements
- Structurally, formal institutions cannot be fully enforced and a large element of informality is a normal characteristic of developing countries



Implications: Formal Institutions work differently





Further Implications

- Informality is not a pathology that is due to ‘inappropriate’ culture or weak enforcement that can be corrected by administrative reforms
- Successful developing countries have a mix of formal and informal institutions that solve particular market failures in *their* context
- **Growth-enhancing Governance implies designing institutions and capabilities that can work in *specific* political settlements to reduce critical market failures**

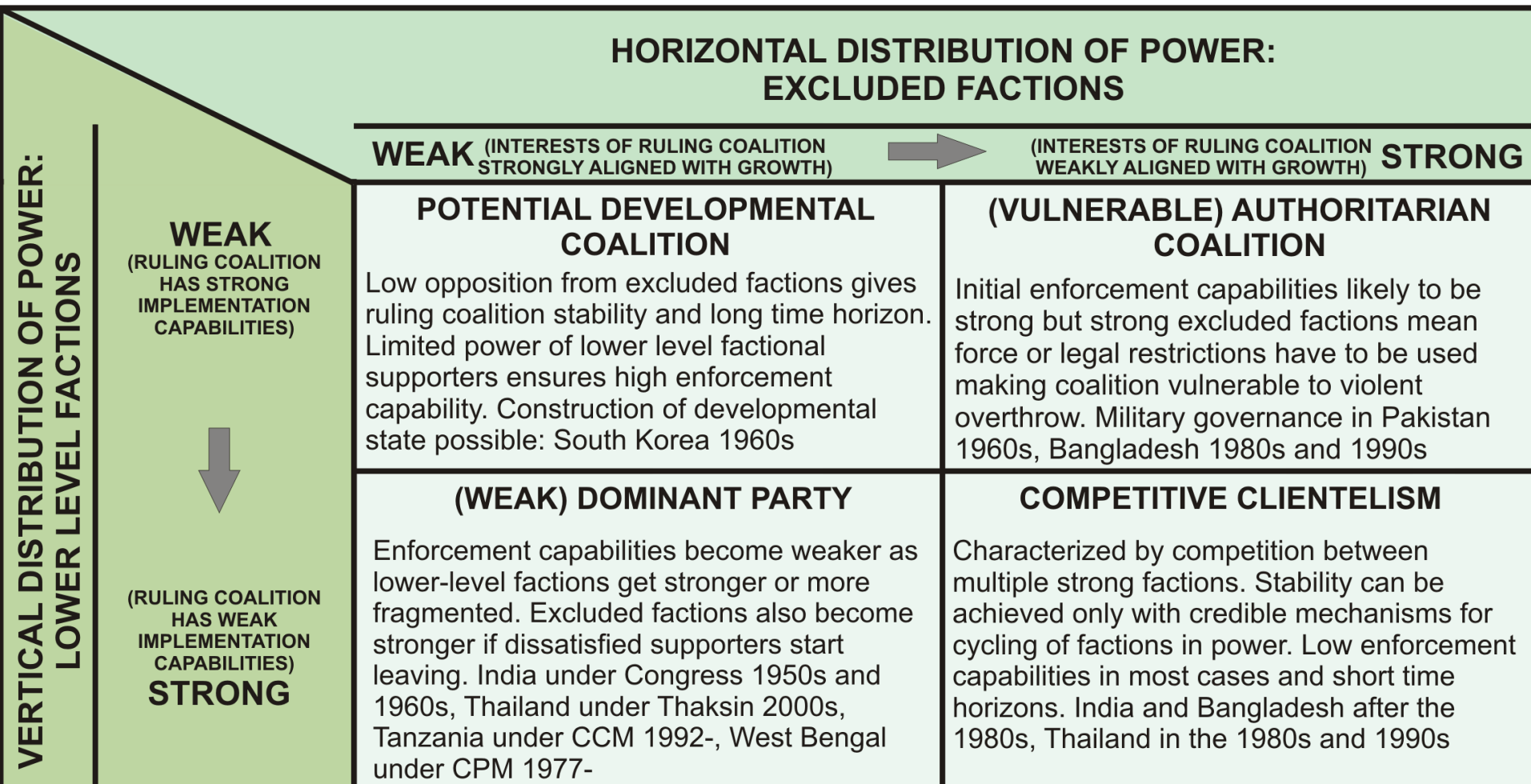


Dimensions of a Political Settlement

- The relevant dimensions of the distribution of power that affects enforcement include
 - ❖ The distribution of power between political organizations (how a ruling coalition is constructed in a developing country)
 - ❖ The distribution of power between economic and political organizations
 - ❖ Both dimensions affect the types of formal solutions to market failures that are likely to be effective



Political Organizations and the Ruling Coalition





Political Inclusion and Governance in Thailand

THAILAND

CHARACTERISTICS OF POLITICAL SETTLEMENT

BROAD FEATURES OF INSTITUTIONS AND GROWTH

Vulnerable Authoritarianism with Weak/Moderate Capability / Politically Weak Capitalists 1960s-1970s

Capitalist rights supporting rapid accumulation but with weak industrial policy institutions

Competitive Clientelism with moderate-to-high capability / powerful capitalists: Mid 1970s-2001

Rapid growth supported by factional capitalist rent-seeking and limited industrial policy

'Unproductive' Dominant Party with high capability / politically delinked capitalists: 2001-2008

Adverse formal institutions supporting growth in formal sector but populist redistribution to the poor. Reliance on foreign investments grows

Backlash: Authoritarianism with a Democratic Face 2008

Political and policy uncertainty



Puzzles, paradoxes and missed opportunities

- Thailand's growth highest during the phase of authoritarian/competitive clientelism
 - ❖ Political settlement allowed capability development
 - ❖ Missed opportunities of addressing specific rent capture problems in the 1990s
- Thaksin's dominant party also highly corrupt, has lower growth but attracts MNC investments
 - ❖ Further missed opportunities in 2002: Populism replaces economic nationalism
 - ❖ Domestic economic organizations sidelined with damaging economic and political consequences



General observations

- Growth takeoffs have been based on institutional-political combinations that can be analysed and understood in case studies
- The default outcome of competitive clientelism enhances political inclusion but creates challenges for constructing growth-enhancing governance solutions
- Governance reforms are deeply political rather than simply technical: an understanding of political settlements and history is necessary for policy evaluation