

Deals and Development: The Political Dynamics of Growth Episodes

SABYASACHI KAR

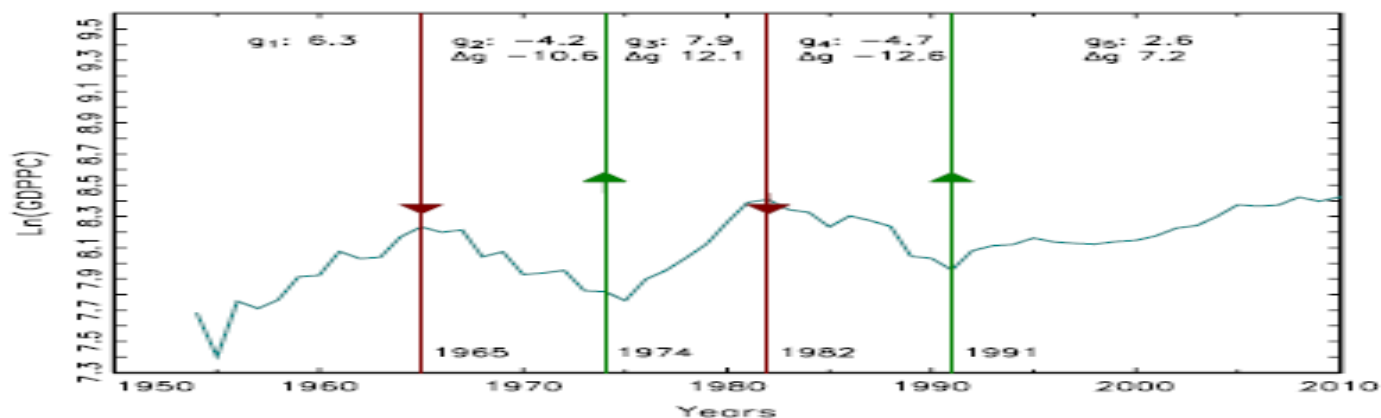
Professor at the Institute of Economic Growth, India

Honorary Senior Research Fellow at The ESID Centre, University of Manchester

**Based on forthcoming OUP book, edited by Lant
Pritchett, Kunal Sen and Eric Werker**

Understanding That Steady-States Do Not Describe Growth Very Well

- Much of the focus in the academic and policy literature on “growth” has been on long-run steady-state growth of output
- However, massive discrete *changes* in growth are common in developing countries (eg. Jordan).



- Thus, most developing countries experience a number of distinct growth *episodes*, rather than one steady-state.

A Political Economy Theory of Growth Episodes

Intermediary Variable:

- The Deals Environment in the Institutional Space

Core Variables:

- The Political Settlement in the Political Space
- The Rents Space
- The Economic Ideology of the Political Elites

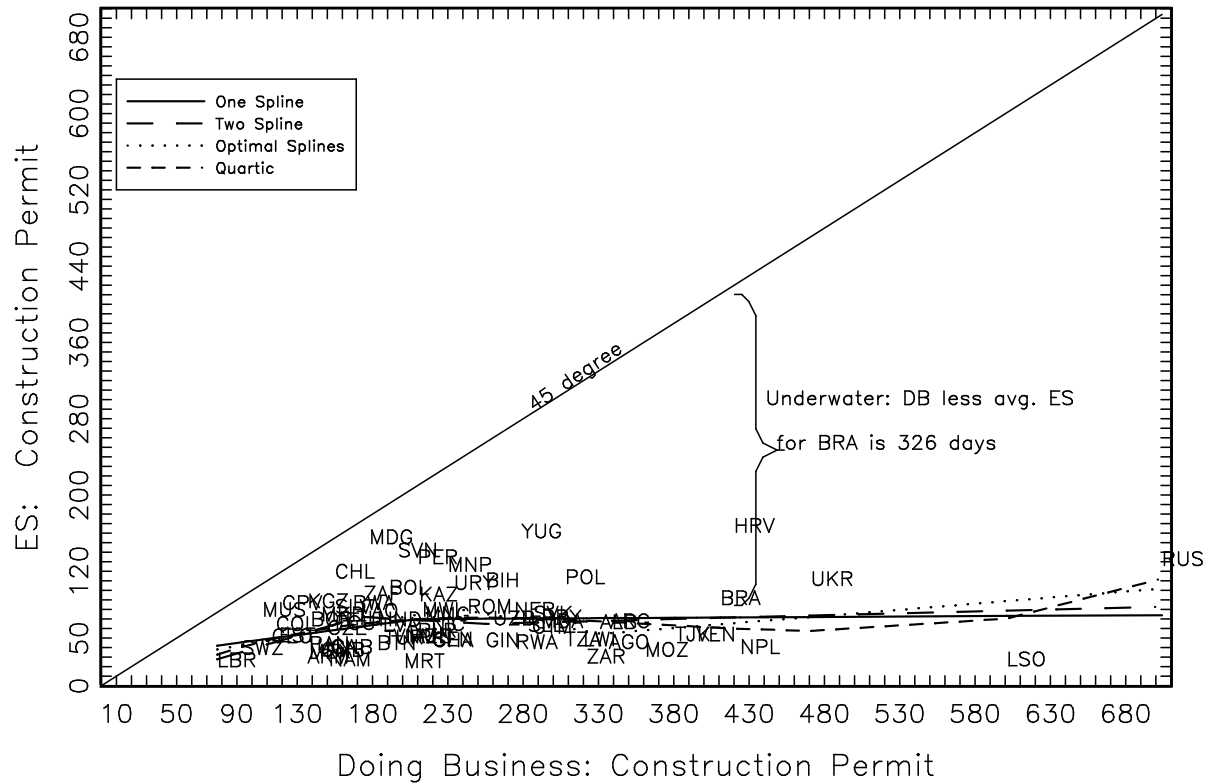
The Institutional Space: “Deals” not “Rules” are King

- **Understanding variation in growth requires understanding differences between countries of similarly bad institutions**
- Deals, not Rules, dictate the terms of most investment decisions
 - In a deals world, investor terms and protections are selectively enforced
 - Not the neutral application of policies, but a firm/investor specific arrangement
 - Subject to change depending on regime/administration and business-government relations
- Which business interests are present determines the overall demand on government to set policy vis-à-vis the private sector
- This leads to feedback loops that, mediated through the political settlement, determine the dynamics of growth episodes

De Jure Rules meet De Facto Deals

(Hallward-Driemier and Pritchett 2015)

Figure 9: Doing Business and Enterprise Survey: Construction Permit (Actual and Predicted Values)



Its Who You Are That Matters

Figure 10a: DB versus ES 10th percentiles:
Construction Permit

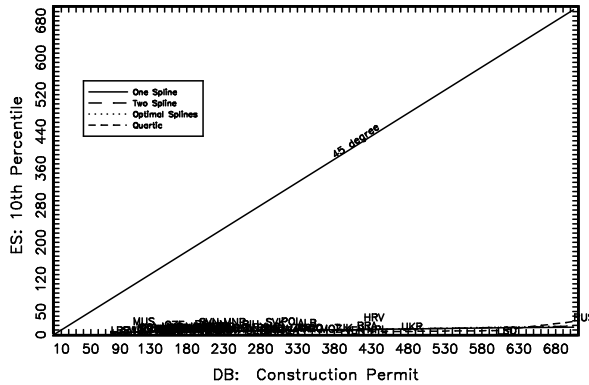


Figure 10b: DB versus ES (25th Percentile)
(Construction Permit)

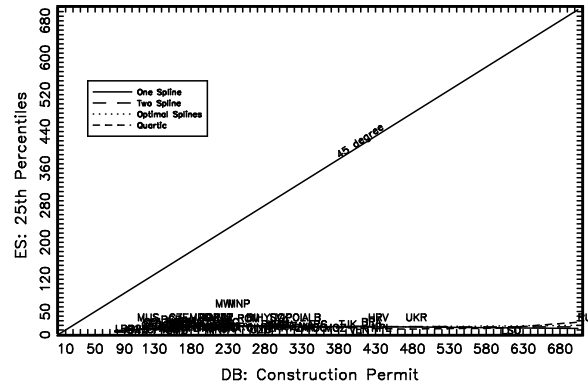


Figure 10c: DB versus ES 75th Percentiles
(Construction Permit)

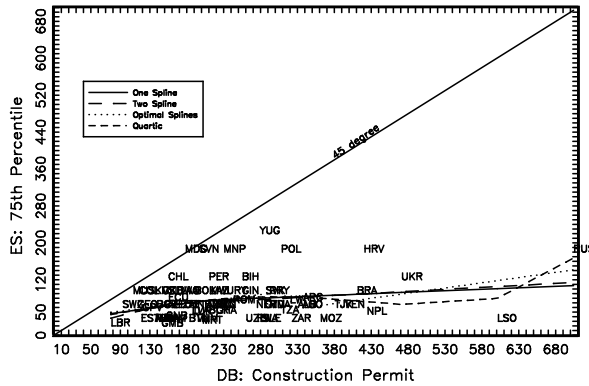
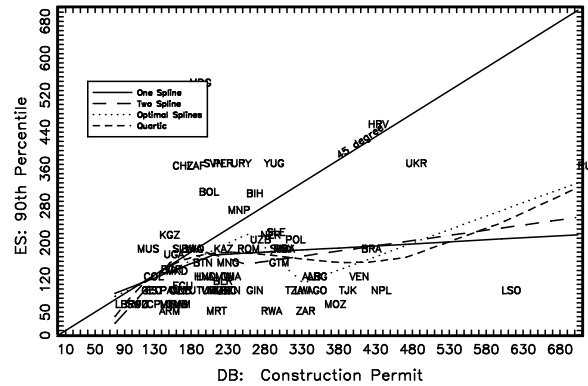


Figure 10d: DB versus ES (90th percentile)
Construction Permit



The Deals Space

	Open	Closed
	(deals depend on <i>actions</i> of agents (including influence activities) but not identities)	(deals are available only to specific individuals or organizations—deals depend on identities)
Ordered (deals done stay done, predictable)	“Retail” corruption (e.g. driver’s licenses in Delhi)	“Cronyism” (e.g. Indonesia under Suharto, Russia under Putin, China, Korea (1960s))
Disordered (unpredictable what deals are available, deals have uncertain time horizon)	“Informal” sector in many countries	“Fragile” states

The Political Settlement

- “The interdependent combination of a structure of power and institutions at the level of a society that is mutually ‘compatible’ and also ‘sustainable’ in terms of economic and political viability” (Khan 2010).
- Balance of power between economic and political elites – who has the power? How do they wield it? How stable is the balance of power?

The Distribution of Horizontal and Vertical Power in Dominant and Competitive Settlements

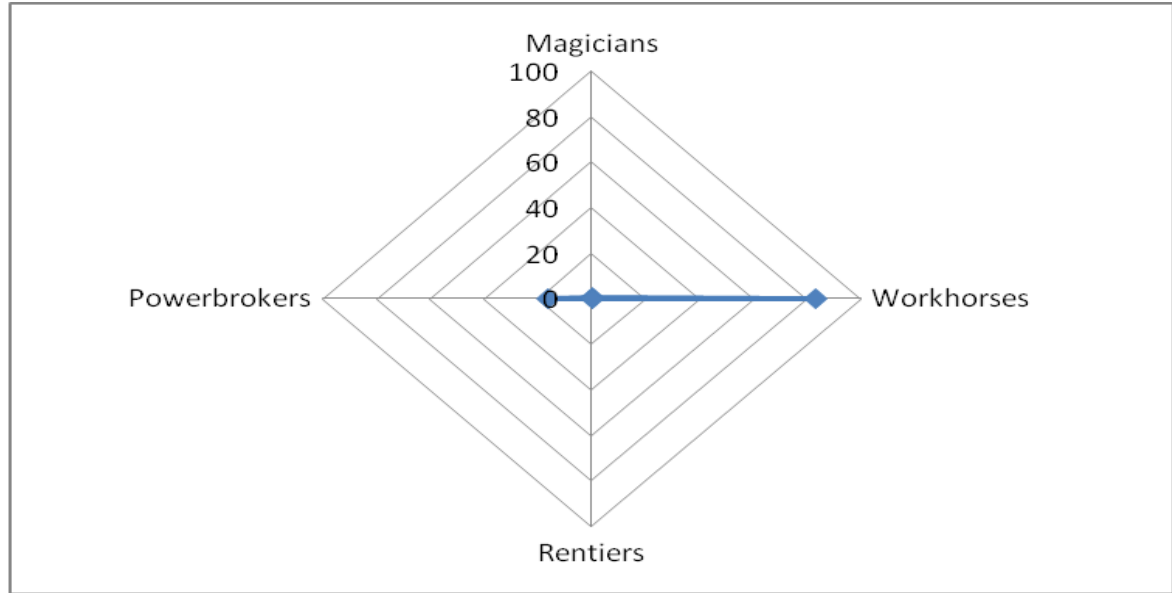
VERTICAL/HORIZONTAL DISTRIBUTION OF POWER		HORIZONTAL DISTRIBUTION OF POWER: POWER OF EXCLUDED FACTIONS	
		WEAK	STRONG
VERTICAL DISTRIBUTION OF POWER: POWER OF LOWER LEVEL FACTIONS	WEAK	STRONG DOMINANT PARTY	VULNERABLE AUTHORITARIAN COALITION
	STRONG	WEAK DOMINANT PARTY	COMPETITIVE CLIENTELIST

The Rents Space

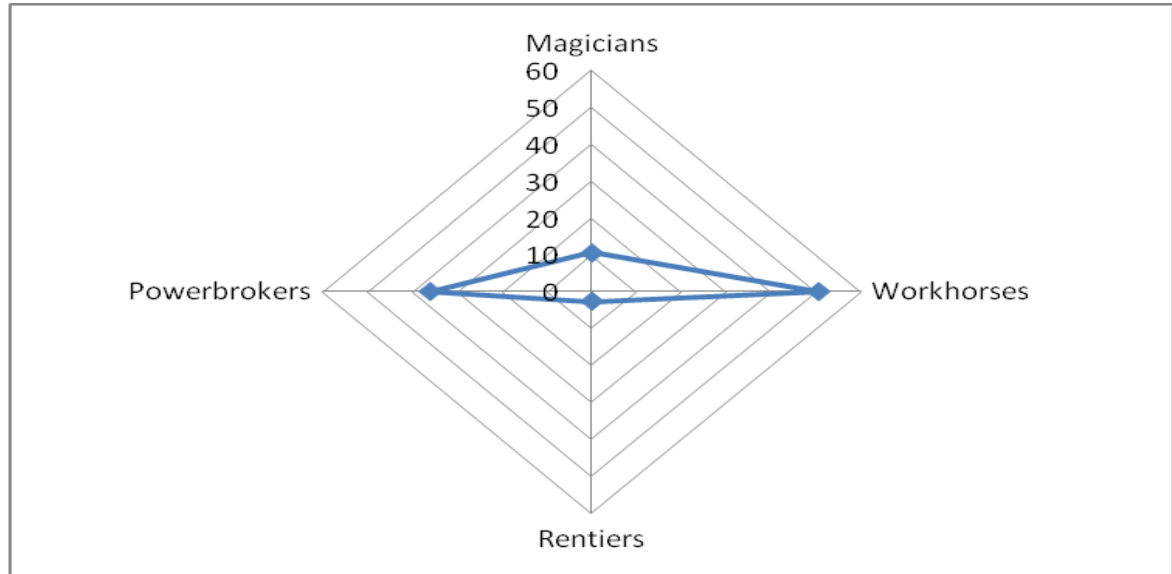
	High Rent	Competitive
Export-Oriented	RENTIERS Iron ore, gold and diamond miners, tree crop with tax concessions, forestry	MAGICIANS Agro-processing, manufacturing
Domestic Market	POWERBROKERS Legislative monopolies or oligopolies (petroleum Distribution) Natural monopolies or Oligopolies (telecommunications)	WORKHORSES Traders, retailers, subsistence farmers

Rent Space

India's Rents Space, 1960-81



India's Rent Space, 2005-06



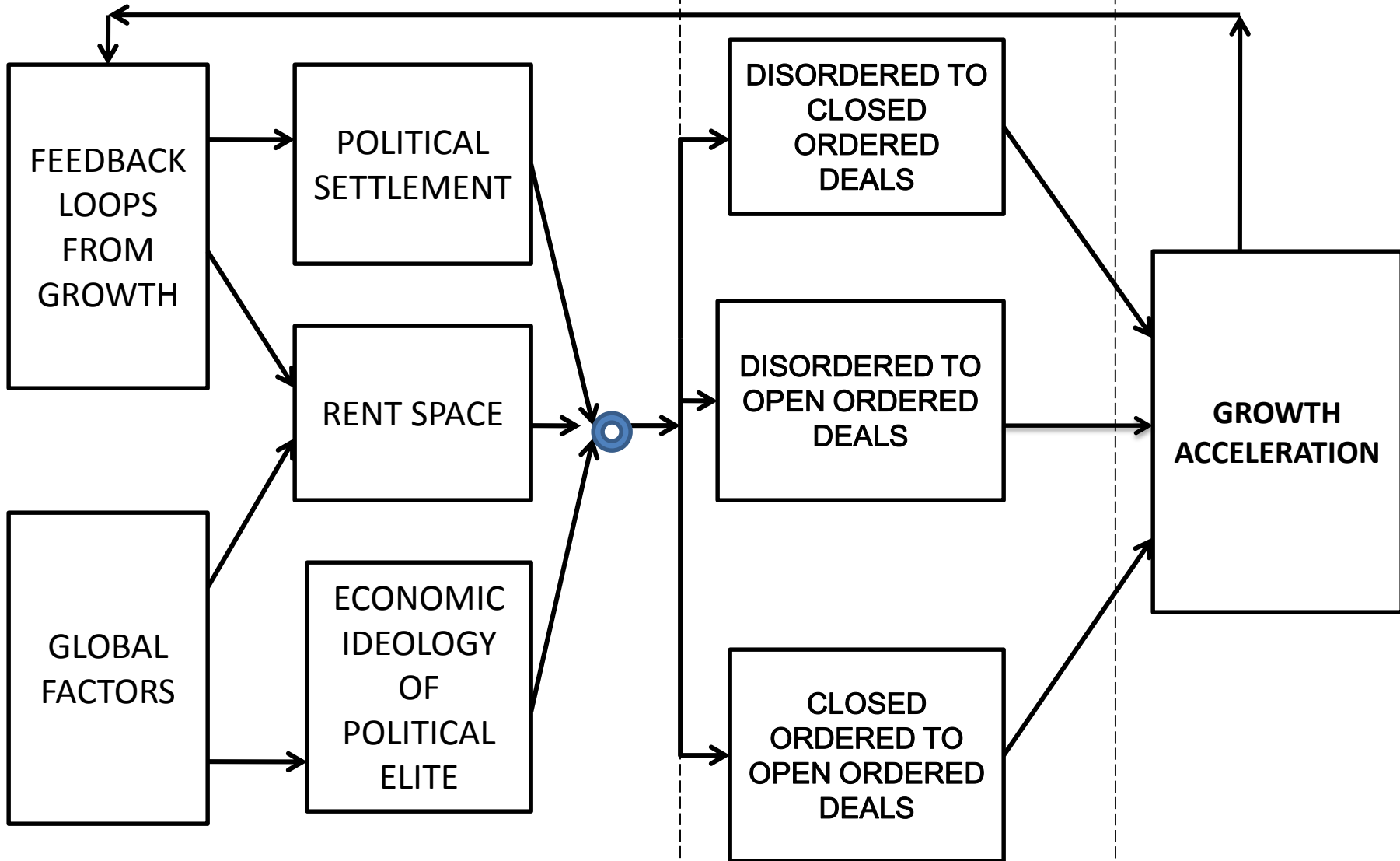
What do different parts of the rent space want?

	High-rent	Competitive
Export-oriented	<p>RENTIERS <i>Policy:</i> Low tax regime, reduced red tape, non-intervention <i>State Capability:</i> good infrastructure (can be cocooned), order, low capability to regulate, negotiate, enforce</p>	<p>MAGICIANS <i>Policy:</i> Low taxes, reduced red tape <i>State Capability:</i> Market-friendly intervention (e.g. productivity, de-bottlenecking), good infrastructure (can be cocooned, e.g. Special Economic Zones),</p>
Domestic market	<p>POWERBROKERS <i>Policy:</i> Barriers to entry, high tariffs, market distortions <i>State Capability:</i> Weak institutions, lack of transparency, no bureaucratic autonomy, order without rule of law</p>	<p>WORKHORSES <i>Policy:</i> Low taxes, minimal red tape, good infrastructure (has to be general infrastructure) <i>State Capability:</i> Need some governmental capability (e.g. power, roads), would prefer “open order” to reduce costs from “powerbrokers) but will settle for open ordered deals.</p>

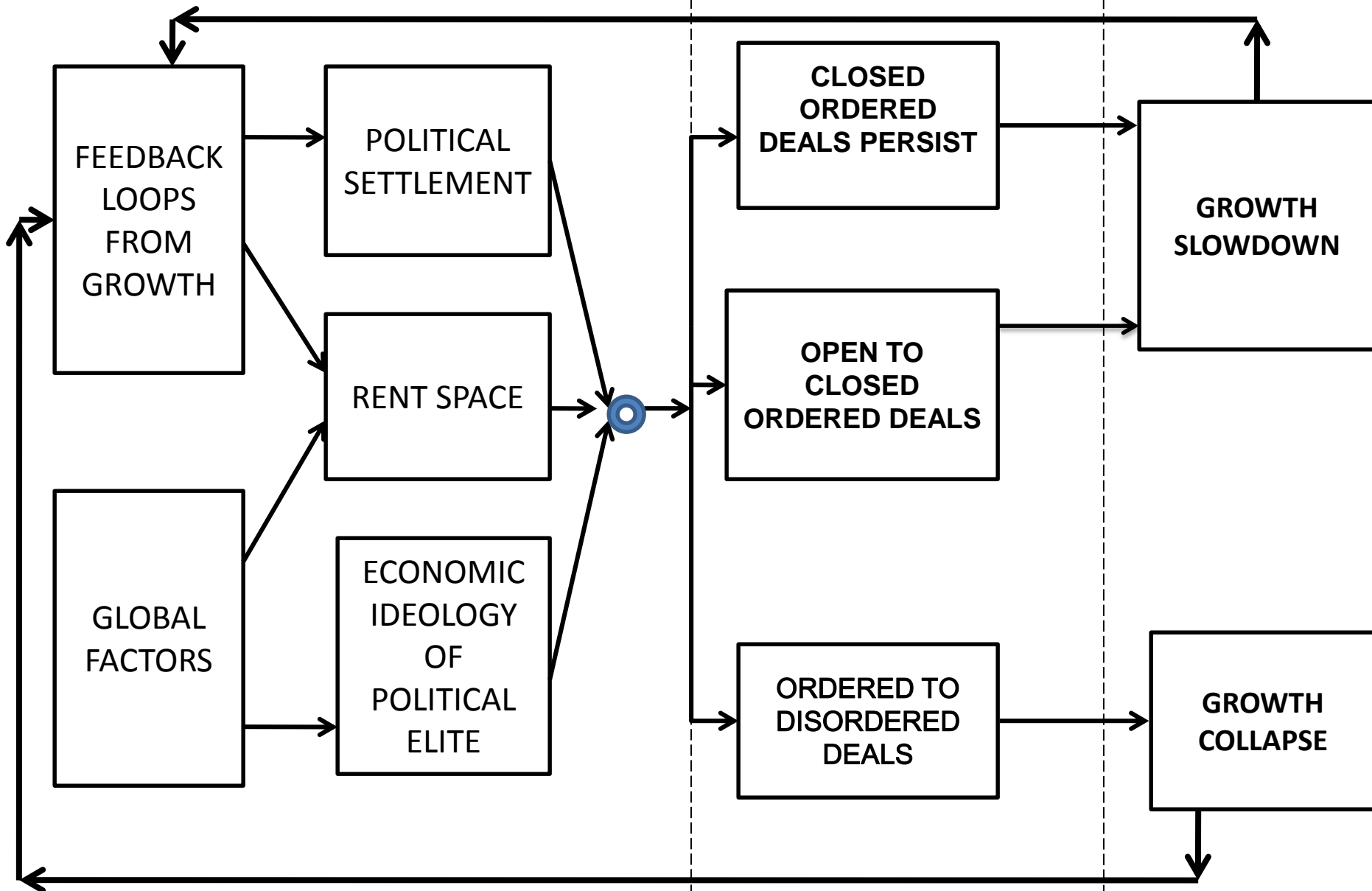
Explaining Growth Episodes

- Our Growth Framework is a Political Economic Theory of Growth Episodes
- We explain growth accelerations and growth slowdowns/collapses using the concepts described before

GROWTH ACCELERATIONS



GROWTH SLOWDOWNS AND COLLAPSES



Two Feedback Loops from Growth

- **First, economic in nature.** Depends on the rent space. Since rentiers and powerbrokers benefit from closed deals, a growth episode that empowered them would likely lead to a closing of the deals space. This may give rise to a **negative feedback loop** as a result of structural transformation. On the other hand, a growth episode that empowered magicians and workhorses would likely lead to a **positive feedback loop** through an opening in the deals space, enabling structural transformation.
- **Second, political in nature.** Depends on nature of the political settlement and how it evolves over time. Also, depends on the political power of firms and on non-elites such as judiciary, middle class and civil society. How they mobilise themselves against elements of the growth process that they see as politically de-legitimate. This can also be **positive** or **negative**.

Applying the framework

- To test this framework, a number of countries drawn from Africa and Asia have been studied which show significant variation across three dimensions:
 - a) the type of the political settlement (whether dominant or competitive),
 - b) where they are located in the deals-rules continuum,
 - c) the nature of growth outcomes.
- In this session, we present two of these case-studies, Bangladesh and India.

THANK YOU