

Politics and Growth

An Analytical Framework

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Contents

Executive Summary	i
1. Introduction	1
2. Evidence on the links between politics and growth	2
3. Donor thinking on politics and growth	5
4. How is economic growth generated? Insights from theoretical & empirical literature ...	6
5. Political relationships underlying economic growth	8
5.1 Predation	11
5.2 Rent seeking	12
5.3 Patronage spending and looting	14
6. State building and growth transitions	14
7. Political incentives for growth	17
8. Factors influencing political incentives.....	18
9. An agenda for development agencies.....	24
9.1 External influences on political incentives.....	24
9.2 Strengthening internal incentives for collective action	25
9.3 Enabling more constructive state-society interaction.....	27
10 Concluding remarks.....	27
Annex – Politics and Growth Assessments.....	29

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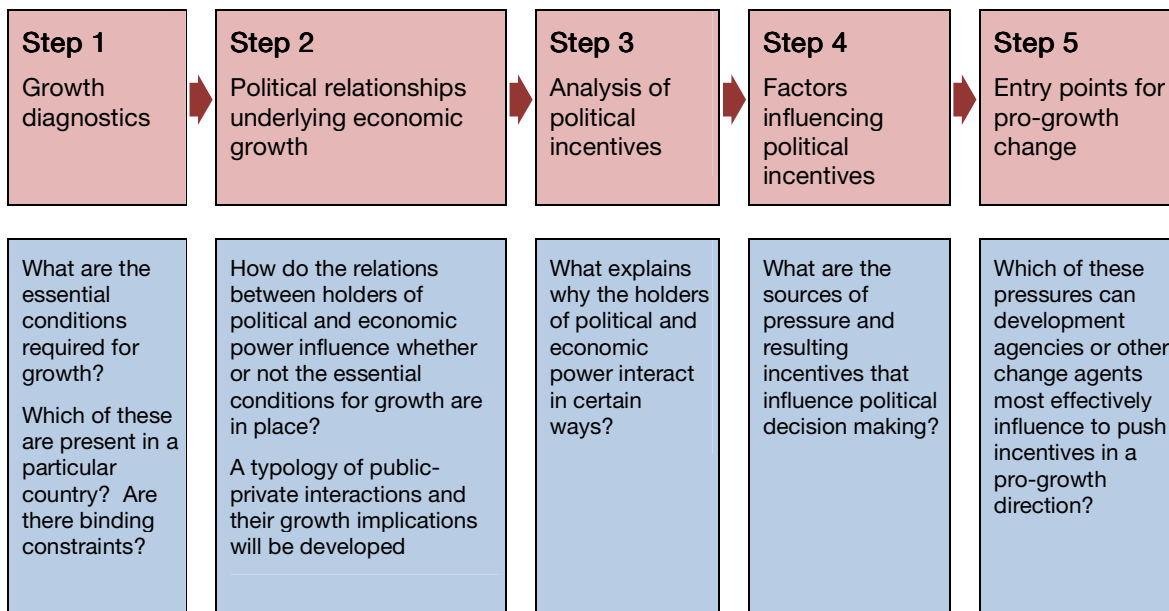
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Executive Summary

The literature on growth focuses mainly on economic explanations, but is largely silent on the impact of politics. Theories of growth highlight the role of factors of production (usually labour and capital investment) and total factor productivity; the latter referring to the efficiency by which factors are combined, as determined by technology, infrastructure, policies and institutions. The empirical literature points to a wide ranging set of factors that are closely associated with growth, though not necessarily causally. Recognising the diversity of country experiences, there has recently been considerable interest in developing growth diagnostic tools to identify specific factors that hold back growth. In a recent influential paper Hausmann, Rodrik and Velasco suggest that growth may be unleashed by relaxing a limited number of country-specific key constraints. These so-called “binding constraints to growth” are grouped under three headings: (1) high cost of finance, (2) low social returns, and (3) low private appropriability of returns.

A number of empirical studies highlight the link between political variables and economic outcomes. While these offer strong evidence of correlation, they do not explain causality, and provide little insight into the mechanisms by which political processes influence growth. In this briefing paper we present a framework to help clarify these mechanisms and analyse how they operate in different country settings. The central contention is that growth is strongly influenced by the nature of interactions between holders of state power (political and military elites) and potential investors. The focus is on the incentives facing these actors that explain why in different circumstances they interact in ways that may either enable or hinder growth.

There are five steps in the discussion that follows:



Step 1 – Growth Diagnostics

The empirical literature points to a wide ranging set of factors that are closely associated with growth. By grouping these factors we can identify three that are particularly important:

- ① Freedom from expropriation – investors need confidence that they will be able to retain their assets and an adequate share of the proceeds.
- ② Well functioning, competitive, appropriately regulated and internationally open markets operating in stable macroeconomic conditions, and
- ③ Adequate and appropriate investment in public and semi-public goods, in particular infrastructure, human capital and technology, which would be underprovided by the private sector acting alone.

The diversity of country experiences suggests that these conditions should not be interpreted rigidly as a guide to policy reform. They do not imply the need for a specific set of best practice institutions, as the above conditions can be met through different (sometimes informal) arrangements that are suited to particular settings. Not all of these conditions need to be fully satisfied to kick-start growth (although the first seems critical); but major deficits in any of the three will inhibit sustained growth. In poor countries with weak institutions it is particularly important to identify which factors act as binding constraints to growth and to target reform measures accordingly. Growth diagnostic tools can be helpful in this regard.

Step 2 - Political relationships underlying economic growth

Each of the above conditions for growth depends on politics, in particular the relations between those who control political power and the use of force, and those who control private capital. Holders of political power and private capital stand to benefit from co-operation, but also face risks in doing so. Political leaders need business to provide state revenue, finance political parties, and invest to create prosperity that supports political order. Holders of private capital need public authority to provide law and order, a good financial and regulatory environment and a range of public goods. But there are risks and obstacles to co-operation. Holders of political power face strong temptations to control private capital for their own personal or group aims. Private capital has the capacity to capture state power in support of vested interests.

Typically in OECD countries relationships between public authority and private capital are underpinned by widely accepted societal norms, formal rules and institutions (of liberal democracy, market capitalism and welfare states) that provide strong incentives for cooperation and that limit abuse by either party. However, the problem in many developing countries is that they are still at early or intermediate stages of state building where institutionalised relationships and checks and balances are often weak, and there is no clear consensus within civil society on governance norms. In these conditions there are likely to be

inherent sources of tension between different holders of power that undermine growth. Moreover, holders of political power may have little incentive to nurture broad based development if they have access to external sources of wealth (aid and natural resource exports) that frees them from dependence on taxpayers.

We identify three types of obstacle to growth (predation, rent-seeking and patronage spending) and various sub-types that are created by specific kinds of public-private interaction. These relate closely to the three essential conditions for growth (step 1), as outlined in the table below:

Growth obstacles arising from different types of public-private interaction

Condition for growth	Growth obstacle arising from specific kinds of public-private interaction	Sub-types
Freedom from expropriation for investors	Predation <i>(theft of resources)</i>	Private predation <i>(one private agent steals from another)</i>
		State predation <i>(holders of public office steal from private agents)</i>
Competitive markets	Rent-seeking <i>(capture and exploitation of public regulatory power by private interests)</i>	Extractive rent seeking <i>(rent seeking reduces growth, proceeds not reinvested)</i>
		Dividend collection <i>(rents are generated by growth and some are reinvested in productive activities)</i>
Adequate investment in public and semi-public goods	Patronage spending <i>(directing public spending into private hands)</i>	<i>e.g. costly and poorly targeted subsidies, public sector wages and pork barrel projects that benefit narrowly targeted groups. In a more extreme form holders of public office may loot public resources</i>

The types of growth obstacle that are highlighted are:

- **Predation:** the expropriation of assets, which can be divided into two sub-types: *private predation* (one private agent stealing from another, generally most serious in conditions of violent conflict, insecurity, lawlessness and state collapse), and *state predation* (the theft of privately held resources by public officials for personal gain outside of regular and legal mechanisms for government revenue collection). Both undermine investment.
- **Rent-seeking:** the capture of public regulatory power by private interests to gain access to economic rents, through such means as the granting of monopoly rights, imposition of import tariffs, quotas and prohibitions, rationing of licenses, bias in award of public contracts and selective enforcement of laws, contracts and property rights. Some commentators have argued (contentiously) that where rents are invested productively in dynamic sectors they can be a source of growth. This is reflected in the distinction in the table between *extractive rent-seeking* and *dividend collection*.
- **Patronage spending and looting:** The diversion of public resources towards private interests (rather than towards the provision of public and semi-public goods that are needed to underpin growth) occurs through:
 - a) looting (the theft of public resources by public officials for personal gain, often in the form of grand corruption in public spending, but also involving illegal extraction and sale of natural resources for private gain); and
 - b) the use of public spending as a tool of patronage to bolster political support and buy off political opponents. Different degrees of patronage spending are common in democracies at all levels of development; it is also used in autocracies as a means to create supportive interest groups and to counter threats to the regime.

The political obstacles to growth described above are present to a greater or lesser extent in all countries, but are each broadly associated with different economic structures and stages of state building. Mineral and oil wealth invites looting. In collapsed states the immediate challenge is to establish or restore government authority in order to *restrain private predation*. Once state control has been established the challenge is to develop relationships of trust between public authorities and holders of capital that are sufficient to provide investors with confidence that their assets will not be expropriated, and give governments an interest in nurturing growth and restraining predation and looting. At intermediate stages of state-building, trust-building mechanisms usually involve personalistic, “hand-in-hand” relations between different holders of power. In these conditions *rent-seeking* and *patronage spending* are particularly likely to arise. The conventional response of donors has been to advocate the creation of formal legal institutions to counter these tendencies and impose checks and balances. This approach has had limited success, not least because patron-client relations often provide the basis for regime survival and stability.

Step 3 – Analysis of political incentives

In seeking to understand what might help make relationships between public and private agents more conducive to growth it is essential to analyse the incentives and restraints facing different actors, as well as their capacity to respond to incentives. The key questions to consider are:

- Why do the holders of political power engage in predation, rent seeking and patronage instead of nurturing growth?
- What might encourage more productive co-operation between politicians and investors?

Incentives can be understood in terms of two inter-related components: (i) the individual's personal motivations, and (ii) the individual's principal economic and political relationships. The first component may be very influential in the short term, but outsiders have little influence over whether reformers acquire power. In order to understand the second component, it is important to look broadly at the pressures acting on individuals that may arise from a variety of sources including:

- **Electoral.** How do politicians win elections? To what extent does the need to win votes influence their behaviour?
- **Patronage.** To what extent are politicians beholden to key individuals and groups who helped to get them into power?
- **Economic.** What are the business interests of politicians?
- **Force.** Is there a threat to the regime from within the security forces or rebel forces?
- **Judicial.** To what extent are powerful politicians and businesspeople subject to the rule of law?
- **Civic.** To what extent are politicians beholden to public opinion? How do they respond to public protests? Does the state use its monopoly on violence to repress political opposition?

Step 4 - Factors influencing political incentives

The numerous factors that influence political incentives tend to be country-specific, and are best understood through in-depth studies examining local political, social, cultural and economic conditions and processes. The main variables to consider in country analysis are set out below:

- The **structure of the economy**, which has a fundamental bearing on the configuration of interest groups and their influence on political incentives.
- The **source of government revenues**: in natural-resource-rich or aid-dependent countries governments gain easy access to revenues without having to rely on ordinary taxpayers.
- The **nature of the political system**: the extent of political competition and the rules by which politicians gain and hold onto power will affect political calculations and incentives.
- The **use of force**: political elites seek a monopoly on violence, and have a strong interest in preventing other groups from threatening the regime or creating generalised instability.
- **Collective action**: organised groups outside of the state can apply pressure collectively on political leaders through non-violent means to pursue shared interests. These may include:
 - **Business organisations**: the influence of business organisations on the political incentives for growth will depend on whether they are able to lobby collectively in the common interest, or whether they respond mainly to sectoral- and firm-specific interests geared towards rent-seeking and limiting competition.
 - **Organised labour**: in many developing countries organised labour is associated with protected industries and public sector employment, and is potentially a beneficiary of rent seeking and patronage.
 - **Consumer groups** are a potential source of pressure for greater liberalisation and competition in the economy.
 - **Other civil society organisations and the independent media** play a key role in exposing acts of predation, generating public pressure for change and ensuring that legal sanctions are put in place.
- **Competing loyalties between the state and traditional ethnic, kinship and communal ties** will also influence public expectations of government and may shift the incentives on political leaders towards dispensing patronage.
- **The breadth and nature of the business interests of political and military leaders** are relevant to whether they have incentives to nurture growth or to protect their own narrow, short-term interests by placing restrictions on potential competitors.
- **The capacity of bureaucracy** strongly determines how well policies are formulated and implemented. In the absence of effective **checks and balances** on the bureaucracy, officials may commonly engage in practices of predation, rent seeking, looting and patronage.

Step 5 – Entry points for pro-growth change

We have argued that economic growth depends critically on the relationship between the holders of political and economic power, and the incentives facing these actors. Development strategies are not likely to succeed unless they take account of these factors. The emphasis needs to be on looking for where there are already local incentives and pressures for change, and seeking ways of building on those to help to push political incentives in a pro-growth direction. There are a great many different factors that have the potential to contribute to this over the medium term, including broad socio-economic change, the emergence of a middle class whose economic interests are aligned with private sector-led development, the organisation of stronger business, professional and other interest groups, and more effective investigative reporting by the media. But in the short term the focus should be on increasing incentives for productive investment, since this is the variable most closely associated with economic growth. This means focusing on incentives of government and investors through the following types of action:

- **International action** can be important, including: (1) action to end conflicts and promote peace building; (2) action to limit access of political elites to external rents (e.g. through OECD action to combat corruption, money laundering and the expatriation of stolen assets), and the Extractive Industries Transparency Initiative; and (3), providing market incentives (for example the Forest Law Enforcement Governance and Trade initiative).
- **Domestic policy** provides the most important means for government to give investors the minimum assurance they need that they will be able to profit in future from investment decisions made now. As the case of China shows, this may not mean introducing legal protection for property rights, at least in the first instance: relatively small, context specific actions or political signals from government could help increase the predictability of the investment environment.
- There may be scope to increase confidence on both sides by supporting **more constructive forms of state-society interaction** that can increase levels of trust. Strengthening some aspect of government performance could help increase expectations and thus incentives for collective action. For example, a widely perceived reform success, effectively communicated, could create pressure for further improvements. Changes to the tax regime, or to the relations of revenue authorities to taxpayers, could also trigger a constructive process of bargaining. Increases in the level of transparency regarding government performance, opportunities for citizen feedback on government performance and participation in key areas of policy (taxation policy, public expenditure, local development planning and business regulation) could all help increase productive engagement.

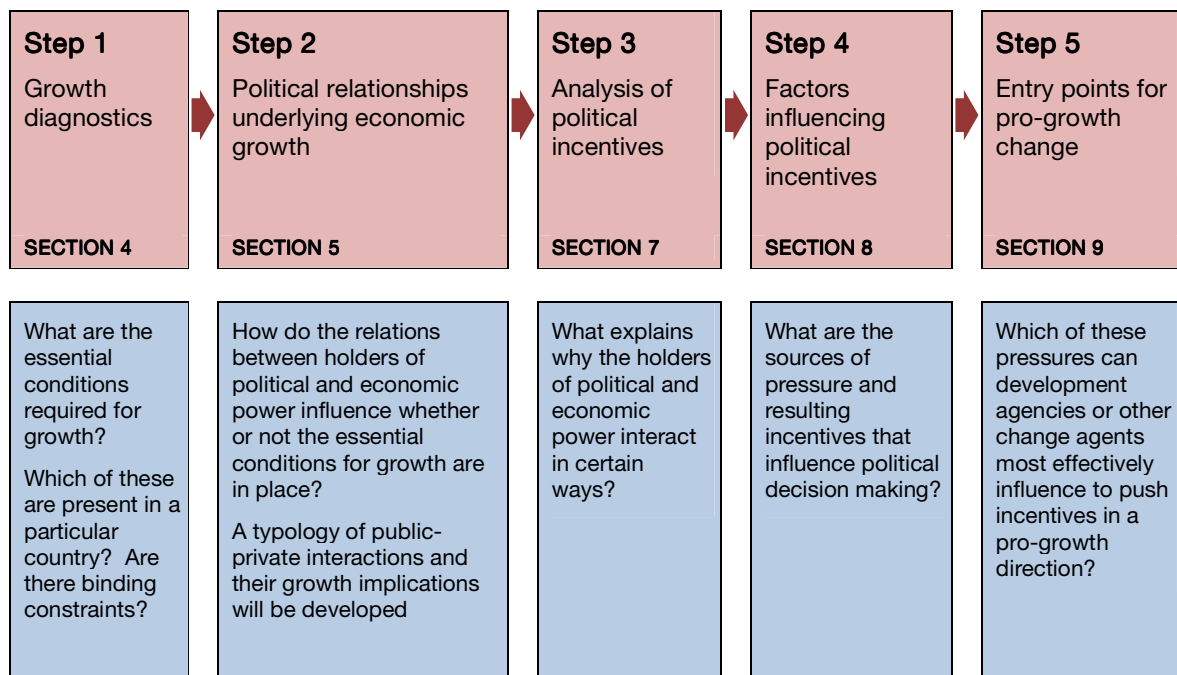
The process of growth and governance reform is iterative and interdependent. A reform measure opens up new opportunities or incentives for productive investment and growth, which in turn generates new pressures for reform. There is no rigid sequence for reforms, though some measures will be more critical than others. Country circumstances and the specific way political power is constructed will dictate which route should be followed to achieve a virtuous interaction between governance reform and growth. In order to illuminate these pathways growth diagnostics needs to be combined with political economy analysis and in-depth country knowledge.

Politics and Growth - An analytical framework

1. Introduction

This paper presents an analytical framework to explain how political processes influence economic growth. Too much theory and analysis of economic growth only considers *what* policies and institutions are required, without explaining *how* these come about. This, the 'how', we refer to as the politics of growth, being the processes of conflict, negotiation and cooperation between interest groups in the use, production and distribution of resources.¹ Political processes shape economic and social outcomes. They can promote economic efficiency and equity ultimately leading to growth and poverty reduction. However, politics often provides the explanation for the absence of growth, particularly in the context of weakly institutionalised states where politically and economically powerful groups seek to extract benefits for themselves and their supporters by engaging in predation, rent seeking and patronage. Overcoming these problems and generating sustained growth depends critically on the nature of political incentives.

The central question addressed by this paper is “*what drives the holders of power to act in ways that generate sustained growth?*” We address this question by developing a five stage framework as presented below:



¹ This is based on the definition of politics is taken from Leftwich, A. (2006) *From Drivers of Change to the Politics of Development: Refining the Analytical Framework to understand the politics of the places where we work*. DFID. It should be noted that this definition excludes important areas of political discourse, such as social and human rights.

The first step is to identify the basic conditions that are essential for growth using growth diagnostic tools (Section 4). The second step is to link these basic conditions to the political relationships underlying growth (Section 5). We argue that growth depends on politics, in particular the relations between those who control political power and the use of force, and those who control private capital. These relationships change slowly as part of state building processes involving conflict, negotiation and bargaining between different holders of power (Section 6 describes how such transitions occur). The third step is to explain these interactions in terms of the political incentives facing the holders of power (section 7). The fourth step is to examine the factors operating at the country level that may help to push incentives in a pro-growth direction (section 8). As the final stage in the analysis we consider the entry points for pro-growth change and the practical implications for the design of development programmes (section 9). The framework is presented in general terms, and is intended to guide more in-depth, country-specific analysis. The annex presents a method for undertaking Politics and Growth Assessments at the country level.

Given the broad and ambitious scope of this paper and the resource limitations of this exercise, it has been necessary to skate over many complex and controversial questions. The paper attempts to highlight those propositions and empirical findings from the extensive literature that are particularly relevant to understanding the interaction between politics and growth. This focus excludes many important questions. We discuss politics purely in *instrumental* terms in terms of its impact on economic development, but recognise that politics also has other *intrinsic* values where it may help or hinder securing the principles of empowerment, democracy and human rights. We recognise that economic growth does not capture all aspects of development. In particular, there are distributional questions of who benefits from growth that are discussed at various points in the paper, but would merit a separate and more complete analysis. It is also worth highlighting that politics is not the sole determinant of growth, and that non-political factors, such as geography, weather, commodity price trends and technological development have an important influence. In spite of these caveats, we argue that politics provides a large part of the explanation of why different countries grow at different rates. These issues have been curiously neglected in theories of growth and development practice.

2. Evidence on the links between politics and growth

Evidence on the links between politics and growth is provided by quantitative analysis (cross country regression) and qualitative research (historical analysis and country case studies). Such evidence has established that over the long-term there is a clear connection between political and economic change. However, there is limited hard evidence on the direction of causality, and the basic mechanisms through which politics affects growth and vice versa.

Quantitative analysis demonstrates a strong correlation between levels of income and aspects of good governance, such as market capitalism and liberal democracy. While this points to a clear association between political processes and growth over the long term, it

does not prove a causal relationship, or settle the much debated question of whether political change generates economic development, or the other way around, or both.² Furthermore, over the short- to medium-term variations in growth performance appear to be only loosely related to differences in governance. Studies comparing successful and less successful developing economies find that there is no significant difference in the quality of governance.

³

Recent progress in developing governance indicators has provided further insights into the links between politics and growth, but difficult problems of measurement remain (box 1). Many indicators rely on perception based measures, and are highly influenced by subjective factors. Most of the indicators focus on attributes of governance, such as corruption or voice and accountability, which reflect the outcomes of politics, but do not illuminate the political processes and incentives at work. Another tendency is to aggregate different sources of information in composite indicators, which makes it difficult to identify specific factors and mechanisms at work.

Qualitative research based on in-depth country analysis provides an additional, and arguably richer, source of evidence on the links between politics and growth. Historical studies provide important insights on how developed countries underwent state formation through linked processes of economic and political change. In developing countries in-depth political economy analysis, such as DFID's Drivers of Change studies, have also improved understanding of how political processes obstruct or enable economic development, and have focussed attention on the incentives influencing the decisions of governing elites and other interest groups.⁴

Taken together the evidence points to the fundamental importance of politics in shaping economic growth, but leaves many questions unanswered. It is important to acknowledge that there are large gaps in understanding, and the many competing theories cannot be adequately tested because of shortcomings in data. The aim of this paper is not to provide definite answers, but to provide a framework to think about the various ways in which politics influences growth and vice versa. It attempts to draw together a wide ranging set of theoretical ideas from a broad literature, and is informed mainly by qualitative studies and direct experience of working in developing countries.

² We would prefer not to be drawn into the rather polarised debate about whether good governance precedes growth or vice versa because the reality is likely to be rather more complex. Politics and growth, as conceived in this paper, describes in iterative and incremental process whereby causality works both ways between different aspects of economic, social and political development.

³ Khan, M. (2006) *Governance, Economic Growth and Development since the 1960s*: Background Paper for the World Economic and Social Survey 2006

⁴ Landell-Mills, P., Williams, G. and Duncan, A. (2007) Policy Practice Brief 1 - Tackling the Political Barriers to Development: The New Political Economy Perspective.
<http://www.thepolicypractice.com/papersdetails.asp?code=8>

Box 1 - Quantitative evidence on governance and growth

Cross country regression analysis points to a strong association between governance variables and income levels. For example, Kaufmann and Kraay (2003) demonstrate a statistically significant correlation between each of the six Governance Matters indicators and levels of income. Other studies point to the particular influence of property rights, the rule of law, corruption and the regulatory burden (see review in IMF, 2003 and Keefer, 2004).

While correlation can easily be demonstrated, causality is much more difficult to prove. One approach is the use of instrumental variables. A famous paper by Acemoglu, Johnson and Robinson (2001) uses historical patterns of colonisation and settler mortality as an instrument for the quality of institutions that have persisted to the present day. They argue that where colonial powers settled they were more concerned with establishing secure property rights rather than simply extraction of resources. The analysis points to a causal link between the quality of institutions and cross-country differences in income. Kaufmann and Kraay (2003) use an alternative estimation method to assert that improvements in governance cause increases in income rather than the other way around.

These and numerous other studies have led to many to assert that “institutions rule” - in other words institutional quality is the key determinant of growth. However, this view has been challenged by other researchers. For example, Sachs argues that geographical and environmental factors, in particular transport costs and malaria transmission, exert the strongest effect on growth, irrespective of institutional quality.

It is notable that attempts to link economic performance to characteristics of the political system have not established clear findings. For example, no difference in growth rates have been observed between democracies and non-democracies (although it is true that countries that were richer to begin with tend to be more democratic).

Some of the main difficulties with existing governance indicators include:

- Almost all econometric studies relate governance indicators to levels of income rather than growth rates. Governance indicators may therefore explain long-term economic performance, but it is impossible to prove whether they drive growth in the short run.
- Most governance indicators are based on perception measures (e.g. the Corruption Perceptions Index) for which only a few years data is available. These are heavily influenced by subjective factors, including recent economic performance (the so-called “halo effect”).
- In other cases indicators rely on proxies that may not well represent what they intend to describe. For example, the holding of elections is not a reliable indicator of the health of democracy.
- Composite measures (e.g. voice and accountability) aggregate different aspects of governance, and do not isolate the basic factors at work.
- Governance indicators tend to measure outcomes rather than causes. For example, in measuring perceptions of the security of property rights, it is possible to demonstrate whether or not investors feel safe, but this does not explain the political processes that generate such security.

Sources:

Acemoglu, D., Johnson, S. and Robinson, J.A. (2001) The Colonial Origins of Comparative Development, an Empirical Investigation, *American Economic Review*
Gray, H. (2007) Governance for Economic Growth and Poverty Reduction, Paper prepared for DFID Empirical Evidence and New Directions Reviewed
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Kaufmann, D. and Kraay, A. (2003) Growth without Governance
Keefer (2004), A review of the political economy of governance: From property rights to voice, World Bank Policy Research Working Paper 3315, May 2004
Sachs, J. (2004) Institutions Don't Rule, Direct Effects of Geography on Per Capita Income, National Bureau of Economic Research, Working Paper 9490.

3. Donor thinking on politics and growth

In spite of the uncertainties in the theoretical and empirical literature, development agencies have taken an increasingly normative view of the importance of good governance as a precondition for economic development.⁵ At the operational level there is an increasing focus on promoting good governance through a wide ranging reform agenda encompassing public administration and finance, the legislature, judiciary and security apparatus. The results of these activities have been rather mixed and the growth impact difficult to discern. Two important observations can be made:

First, good governance, as practised by development agencies, has sometimes been based on an assumption that it is possible and desirable to transplant institutional models from OECD countries to the developing world. Generally, such approaches have not met with success. Experience has shown that institutions work differently depending on the social and political environments. Successful and well-adapted institutions have generally developed incrementally over centuries through domestic pressures and political contestation, often along varied and nonlinear routes. They tend to be context specific and are not amenable to a quick fix.

Second, the good governance agenda has expanded to cover multiple objectives, such as human rights, democratisation, voice and accountability. Although these are intrinsically valuable, a central focus on the factors that matter most for economic development is lacking. Arguably the agenda has become overloaded, and the long list of measures that are prescribed under the label of good governance can only realistically be implemented over the long-term.

These observations point to the need for more connected and informed thinking on political and economic development. There are signs that donor thinking is beginning to change in this regard. For example, DFID's recent White Paper states explicitly that "good governance is about good politics."⁶ DFID's Drivers of Change studies have improved understanding of the importance of political economy factors in bringing about development at the country level, and their findings are beginning to influence its programmes on the ground.⁷ At the same time there are calls for a more selective approach to good governance focussing on the measures that matter most for political and economic development. Grindle advocates

⁵ DFID defines governance as how the "institutions, rules and systems of the state – the executive, legislature, judiciary and military – operate at central and local level, and how the state relates to individual citizens, civil society and the private sector." DFID (2001) *Making Government Work for Poor People, Building State Capability*, page 11, note a.

⁶ DFID (2006) *Eliminating World Poverty, Making Governance Work for the Poor*, p23

⁷ See Landell Mills, P. Williams, G. and Duncan A. (2007) *Policy Practice Brief 1 - Tackling the Political Barriers to Development: The New Political Economy Perspective*, The Policy Practice and Williams, G., Duncan A. and Landell-Mills, P. (2007) *Policy Practice Brief 2 - Making the New Political Economy Perspective more operationally relevant for development agencies*, The Policy Practice, January 2007 - both available at www.thepolicypractice.com

“*Good Enough Governance*”, an approach that directs attention at the essential conditions of governance necessary to allow development to occur.⁸

4. How is economic growth generated? Insights from the theoretical and empirical literature

While emphasising the political influences on growth, it is essential to understand the economic foundations of the growth process. This section briefly reviews key insights from economic theory and empirical evidence.

Growth is the expansion of output per capita over time. Theories of growth explain this phenomenon in causal terms, and highlight the role of factors of production (usually labour and capital investment) and total factor productivity. The latter refers to the efficiency by which production factors are combined, and is determined by technology, infrastructure and institutions, as well as the related policy and incentives framework. Solow’s neo-classical growth model treats technical change as an exogenous factor that is determined outside of the growth process. This has tended to give way to New Growth Theory or Endogenous Growth Theory that views technical change as being generated as part of the growth process. New Growth Theory points to the key role of investment in human capital, knowledge, innovation and improvements in institutional performance - factors that are considered to generate positive externalities, spillovers, synergies, and increasing returns to capital and labour.

The empirical literature points to a wide ranging set of factors that are closely associated with growth, though not necessarily causal. A recent DFID policy paper provides a fairly comprehensive list of factors, whose association with growth is for the most part backed by empirical evidence (Box 2). Drawing on this list we can group the factors under three headings:

- ① Freedom from expropriation – investors need confidence that they will be able to retain their assets and an adequate share of the proceeds.
- ② Well functioning, competitive, appropriately regulated and internationally open markets operating in stable macroeconomic conditions, and
- ③ Adequate and appropriate investment in public and semi-public goods, in particular infrastructure, human capital and technology acquisition that would be underprovided by the private sector.

⁸ Grindle, M.S. (2005) *Good Enough Governance Revisited*, A report for DFID with reference to the Governance Target Strategy Paper 2001.

Box 2 - Ten conditions for growth

A recent DFID policy paper identifies 10 basic conditions for growth, all of which are outcomes of political processes:

- 1 Integration into, and leveraging of, global resources and markets;
- 2 Provision of infrastructure services that can crowd in the private sector. Investments should recognise the need to strengthen local capacity to ensure investments are sustainable, particularly in ensuring appropriate maintenance;
- 3 Improvements to the investment climate – which will include competition and regulatory frameworks and credit rating systems;
- 4 Improved financial intermediation, ensuring that resources are allocated to efficient ends;
- 5 Developing a strong property rights culture;
- 6 Investment in the social sectors to support the accumulation of human capital to increase labour productivity, and per capita incomes. This may include technical and vocational training, as well as secondary and tertiary education;
- 7 Improved governance structures – it will be important to increase institutional capacity to implement growth strategies and policies;
- 8 Access to new technology, expertise and know-how, including imports of capital equipment and investment in domestic scientific/technology research;
- 9 Ensuring growth strategies are environmentally sustainable and tackle gender inequality;
- 10 Ongoing efforts to increase productivity of both labour and capital.

Absent from this list, but of fundamental importance to growth, is the stability of the macroeconomic context (including the fiscal deficit, the current account deficit, the money supply, exchange rate valuation and debt sustainability).

Source: DFID (2007) *Growth and Infrastructure Policy Paper*

The growth literature provides a general understanding of the conditions that are required to bring about growth. However, there are many unanswered questions about which conditions are most significant and what phasing of measures is required. The diversity of experiences of successful economies makes it clear that there are many alternative paths to growth and that different policies and institutions work in different settings. In order to generate growth institutions need to support the *functions* listed above, but their specific *form* can vary widely according to local circumstances.⁹ For example, it is widely recognised that freedom from expropriation is essential for growth (*institutional function*), but this does not necessarily require western style property rights (*institutional form*). Many different forms of institution and land use rights can provide investors with the necessary confidence that their assets will

⁹ The distinction between institutional form and function is made in Rodrik, D. (2004) *Getting Institutions Right* – <http://ksghome.harvard.edu/~drodrik/papers.html>

not be confiscated.¹⁰

These findings are beginning to influence development agencies' thinking about growth strategies. Confidence in the standard policy prescriptions is shifting towards greater recognition of the diversity of country situations and acceptance of heterodox growth strategies.¹¹ The World Bank's landmark *Learning from the 1990s* study reviews the results of economic reforms promoted by the IFIs during the 1990s. It concludes that the benefits of conventional reform prescriptions have often been more limited than expected, policies that have worked well in one place have had a limited effect in another, and that those countries that experienced strongest growth often did so in unorthodox ways.¹²

In a recent influential paper, Hausmann, Rodrik and Velasco develop a methodology to diagnose the factors that act as the "binding constraints to growth" within a specific country context.¹³ These so-called "binding constraints to growth" are grouped under three headings: (1) high cost of finance, (2) low social returns, and (3) low private appropriability of returns. According to this view it is not necessary, and usually counterproductive, to address all of the possible constraints to growth at once. The key to bringing about growth is to identify those factors which are binding at a particular place and point in time, and to target reform measures accordingly.

5. Political relationships underlying economic growth

In the previous section we identified three general conditions for growth that are emphasised in the theoretical and empirical literature. This provides a useful starting point, but misses the crucial influence of politics. Each of the three conditions depends critically on political processes to build institutionalised relations of trust between different holders of power, while at the same time establishing checks and balances to counter potential conflicts of interest. Growth outcomes depend in particular on the relations between those who control political power and the use of force, and those who control private capital.

This is a long term endeavour that has historically occurred through a process of interaction, bargaining and competition between holders of state power and organised groups in society.

¹⁰ An example cited by Rodrik (*op cit*) is the investment boom in China associated with the Township and Village Enterprises (TVEs) that lasted until the mid 1990s. Ownership of these firms was held by local governments, but private investors were keen to invest as partners in spite of the lack of private property rights. The explanation put forward by Rodrik is that investors felt their capital was sufficiently secure because there were strong common interests between investors and local government officials (linked through institutionalised party structures) to generate profits. Rodrik compares this with the introduction of formal private property rights in Russia that in practice provided investors very weak protection because the legal system was not able to enforce them.

¹¹ Rodrik, D. (2006) "Goodbye Washington Consensus, Hello Washington Confusion", *Journal of Economic Literature* available at <http://ksghome.harvard.edu/~drodrik/papers.html>

¹² World Bank (2005), *Economic Growth in the 1990s: Learning from a Decade of Reform*

¹³ Hausman, R., Rodrik, D. And Velaquez A., (1995) *Growth Diagnostics* – available at <http://ksghome.harvard.edu/~drodrik/papers.html>

The process has often been violent, but can provide the basis for increasing both state capability and accountability, if the parties involved can identify common interests and negotiate arrangements to pursue them. Over time this can lead to more civic ways of managing competing interests, and result in the creation of legitimate, stable institutions: arrangements that are valued -- and thus become "institutionalised" -- because they are seen to serve a common purpose.

Institutionalised relationships are vital because growth depends critically on trust and constructive interactions between the holders of state power (political and military) and potential investors. Each stands to gain from co-operation, but incurs risks in doing so.¹⁴ Politicians would benefit from refraining from predation and supporting long-term growth which generates employment, improved living standards and government revenues and political finance. However they face risks that investors will use their economic power to capture state mechanisms or organise violence. Potential investors stand to gain from sacrificing immediate consumption in favour of longer term investment, but need to be confident that their property rights will be protected. Investors also stand to benefit from government provision of public goods and an enabling investment climate.

Historically political development and economic development have been mutually reinforcing as politicians started to see their ability to survive politically as dependent on growth, and investors came to see their interest in renouncing private violence and seeking public goods. However, this was a long term process, and in the absence of institutionalised relations of trust, politicians will be tempted to resort to creating rents and dispersing patronage to buy off opponents with the potential to organise violence, and holders of private capital will seek private advantage through the creation of monopolies, restrictions on competition etc. This form of co-operation - or collusion - can be persistent because it serves the interests of a powerful elite, and can support social stability. But it also presents important obstacles to growth.

Typically in OECD countries growth is sustained through a series of highly institutionalised and mutually reinforcing relationships, between politicians and their electorate, between taxpayers and the controllers of public finance, between the military and civilians, and between political parties and their financiers. Box 3 offers a simplified model.

¹⁴ This idea is developed fully in Moore, M. and Schmidt, H. (2007) *Can we capture the spirit of capitalism? The investment climate debate.*

Box 3 – The political settlement in OECD countries

The current political settlement in OECD countries works through highly institutionalised relationships, whereby market capitalism, liberal democracy and welfare states are mutually reinforcing, and help to sustain long-term growth:

- There is a broad and profound consensus on respecting the rule of law and on the separation of powers.
- Governments are under pressure to deliver jobs and to guarantee minimum living standards (welfare state).
- The private sector finances the state through tax, and the electoral process through political party donations.
- Electoral democracy acts as a barrier to private capital exerting too much political power.
- The private sector can protect its own interests through its ability to move elsewhere.
- Relations between public authority and private capital are relatively indirect.
- The security forces protects citizens against security threats, but poses no threat to elected governments.

While there are important variations between the political and economic systems of OECD countries, the critical requirement for growth is that there are institutions that generate sufficient trust and confidence between different holders of power to enable investment to take place, and that checks and balances exist to counter potential conflicts of interest. Crucially, this is based on respect for the rule of law administered by an independent and honest judiciary.

Source: Moore, M. and Schmidt, H. (2007) *Can we capture the spirit of capitalism? The investment climate debate.*

The problem in many developing countries is that they are still at early or intermediate stages of state building where institutionalised relationships and checks and balances are often weak. This is especially challenging in countries that gained independence after World War 2, where political authority was forged by a departing colonial power, and not through conflict and bargaining with local groups in society over a long period. Ethnic, communal and local ties continue to be strong and there may be little sense of identification with the state or commitment to constitutional processes.

At early stages of state building where relationships are weakly institutionalised, relations between different holders of power will tend to be highly personalised, with benefits accruing to a limited number of insiders. This undermines growth. We identify three types of obstacle to growth and various sub-types that are created by specific kinds of public-private interaction. These relate closely to the three basic conditions for growth as outlined in the

table below:

Table 1 – Growth obstacles arising from different types of public-private interaction

Condition for growth	Growth obstacle arising from specific kinds of public-private interaction	Sub-types
Freedom from expropriation for investors	Predation <i>(theft of resources)</i>	Private predation <i>(one private agent steals from another)</i>
		State predation <i>(holders of public office steal from private agents)</i>
Competitive markets	Rent-seeking <i>(capture and exploitation of public regulatory power by private interests)</i>	Extractive rent seeking <i>(rent seeking reduces growth, proceeds not reinvested)</i>
		Dividend collection <i>(rents are generated by growth and some are reinvested in productive activities)</i>
Adequate investment in public and semi-public goods	Patronage spending and looting <i>(directing public spending into private hands)</i>	<i>e.g. costly and poorly targeted subsidies, public sector wages and pork barrel projects that benefit narrowly targeted groups. In a more extreme form holders of public office may loot public resources</i>

The following sub-sections discuss these obstacles in more detail:

5.1 Predation

Predation refers to the expropriation of assets and can be divided into two sub-types: private predation and state predation.

Private predation (one private agent steals from another) exists in all societies, but is most serious in conditions of violent conflict, insecurity, lawlessness and state collapse. In these conditions the restraints against predation normally imposed by government and traditional authorities are limited or absent. Predatory acts are often violent and unpredictable and impose unacceptable costs and risks of doing business, deterring most types of investor. Private predation is a heavily negative sum game. While a few violent individuals benefit, the

wider social and economic costs can be enormous since violence discourages investment, destroys assets and interrupts productive activities. Growth is usually negative except sometimes in sectors offering exceptionally high returns (e.g. minerals) or in activities connected to the security industry.

State predation refers to the theft of privately held resources by public officials for personal gain outside of regular and legal mechanisms for government revenue collection. It includes a wide variety of illegal transfers, including extortion, confiscation, arbitrary, coercive and punitive extraction of taxes, land grabbing and involvement of public officials in organised crime. The effect on growth will depend on the level, form and predictability of predation, and who it is directed at. Where state predation is relatively low level and predictable (e.g. petty bribes demanded by traffic policemen) private investors will treat this as a known cost of doing business and the effect on their investment decisions may be quite limited. Investors are driven by their perceptions of risk, and will be more discouraged by predation that is unpredictable, large scale and directly threatens property rights.

5.2 Rent seeking

Rent seeking describes the capture of public regulatory power by private interests to gain access to rents.¹⁵ This is often the outcome of a deliberate political strategy: politicians create economic rents by limiting access to resources, using those rents to sustain themselves in power and to buy-off potential opponents. There are numerous ways of generating rents through policy distortions, such as the granting of monopoly rights, imposition of import tariffs, quotas and prohibitions, rationing of licenses, bias in award of public contracts and selective enforcement of laws, contracts and property rights. Rents are shared between business, bureaucrats and politicians. In some cases rents enter government revenues through legal channels (e.g. license payments and income taxes). However, corrupt payments to officials are common, and in some cases may result in substantial market distortions. Generally the opportunities for rent seeking are greater the higher the level of state intervention in the economy.

Rent seeking behaviour is often viewed as a negative factor that constrains economic efficiency and growth (Krueger). Investors who enjoy access to rents benefit from high private returns, but their profits are gained at the expense of competitiveness, efficiency and growth in the broader economy. According to this view of crony capitalism, business thrives by its connections to political power rather than its ability to compete successfully. There are more losers than gainers, but this imbalance is possible because the lobbying power of the beneficiaries of rent seeking is stronger than voice of the broader population who bear the costs.

¹⁵ An economic rent is a benefit that exceeds normal profits that would be generated under a perfectly competitive market. Rents are ubiquitous even in market economies. They are frequently generated by technological and institutional innovation, and competition to earn such rents is a major driver of innovation (Schumpeterian creative destruction). In this paper we are primarily interested in rents that are created by policy distortions, in other words the deliberate creation of rents by governments.

Some commentators have questioned this negative view arguing that where rents are invested productively in dynamic sectors they can be a source of growth. This is reflected in the distinction in table 1 between extractive rent seeking and dividend collection.¹⁶ The former describes cases where economic policies are deliberately manipulated to create rents to enrich businesspeople and government officials, and the proceeds are generally not reinvested in productive activities in the domestic economy. The latter refers to the more optimistic scenario where rents are created in order to direct resources towards dynamic sectors. Business people and government officials share some of the proceeds (often corruptly), but the level of extraction does not threaten growth and the proceeds are generally reinvested in growth sectors.

Several arguments have been put forward supporting the view that under certain conditions rents may play a positive role in promoting economic growth. Khan has argued that at low levels of development the goal of competitive markets is probably not achievable (because of high transaction costs and limited capacity to enforce property rights) and that the effective management of rents provides a second best means to allocate investment towards productive ends.¹⁷ North *et al.* (2006) emphasise the role of rents in limiting violence and creating social stability.¹⁸ Some analyses of rapid growth in the East Asian tiger economies have pointed to the importance of rent seeking in providing political leaders with an incentive to foster growth in dynamic sectors, or have interpreted rent seeking as part of the creation of close ties between business and government that are required for effective exchange of information and policy making. However, others have challenged the accuracy of this interpretation, have emphasised the risks of corruption and crony capitalism, and question the relevance of the East Asian ‘developmental state’ model for countries in Africa and elsewhere.

The role of rents in generating or undermining economic growth has been hotly debated, but there is relatively little solid evidence to support or refute particular claims. It is plausible that under certain conditions rents can play a positive role in generating investment and enhancing stability, but it is also a fact that rent seeking often imposes significant inefficiencies and diverts resources away from their most productive uses. The conventional ‘good governance’ agenda has focussed on eliminating rents. However, if the creation of competitive markets is not a short-term option, an important question for research is to understand the circumstances in which rent-seeking is particularly damaging, and how it might be possible to get growth in spite of pervasive rent-seeking.

¹⁶ This terminology is adapted from Wedemann, A. (1997) Looters, Rent-scrappers and Dividend Collectors: Corruption and Growth in Zaire, South Korea and The Philippines. *The Journal of Developing Areas* (31) Summer

¹⁷ Khan, M. (2006) *Governance and Economic Growth Since the 1960s*. Background Paper for the World Economic and Social Survey

¹⁸ North, D.C., Weingast, B.R. and Wallis, J.J. (2006) *A conceptual framework for interpreting recorded human history*, NBER Working Paper 12795

5.3 Patronage spending and looting

Economic growth requires that public spending is primarily directed at the provision of public and semi-public goods, in particular infrastructure, institution building, technology acquisition and human capital formation. However, in practice a large proportion of public spending is diverted into private goods provision and transfers, such as subsidies, public sector wages and pork barrel projects that benefit narrowly targeted groups.

The diversion of public resources towards private interests occurs because public spending is used as a tool of patronage to bolster political support, and buy off political opponents. Resources are used primarily in political struggle rather than to generate growth. Patronage spending is common in democracies at all levels of development, and may often follow the electoral cycle. It is also used in autocracies as a means to create supportive interest groups and to counter threats to the regime.

The effect of patronage spending on growth will depend on a number of factors, including the extent to which it detracts from public goods and service provision, whether it is very narrowly targeted or more broadly dispensed, and whether the beneficiaries use the resource transfers in a wasteful or productive manner.

In its most extreme type the diversion of public resources into private hands may involve to *looting* of public resources by public officials for personal gain. This may take the form of grand corruption in public spending, but may also involve illegal extraction and sale of natural resources for private gain. Investment decisions may not be immediately affected because looting does not directly threaten private property. However, large scale looting will have a severe long-term impact on growth because it creates a polity that is not interested in enabling private sector development and steals resources that could otherwise be used for public investment.

6. State building and growth transitions

The political obstacles to growth described above are present to a greater or lesser extent in all countries, but are particularly associated with early stages of state building. In collapsed states the immediate challenge is to establish or restore government authority in order to restrain private predation. Once state control has been established the challenge is to organise sufficient countervailing power to prevent the state from engaging in looting and predation. This is a particular risk because when conflict ends, whether through military victory or peace settlement, the individuals and groups who gain power are often those who have become used to profiting from predatory activities.

Historically in Western Europe rulers were forced to bargain with citizens (especially holders of mobile capital) in order to raise revenue, primarily to fight wars with neighbouring states. The experience of being taxed provided strong and continuing motivation for the mobilisation

of groups of citizens with an interest in holding governments to account, and securing access to the policy process. In many contemporary developing countries governments have little incentive to bargain with their citizens – over tax or anything else. A complex set of historical factors, including state formation through colonisation, has resulted in the concentration of political and economic power in the hands of small elites, relatively unrestrained by organised societal interests. The state tends to be powerful in relation to citizens (so accountability is lacking), but weak in its capacity to make or implement policy (capability and competence are lacking).

All developing countries are characterised by personalised, exclusive relationships between holders of state power and citizens. In these conditions predation, rent-seeking and patronage hold a strong social and political logic because they enable the regime to counter opposition and buy the support of powerful individuals. At the same time their weak capacity makes it difficult for states to make credible commitments to citizens to deliver broad-based growth, and will tend to favour reversion to more easily managed clientelist strategies. North et al. (2006) call this arrangement a limited access social order. Essentially the political system is used to restrict access to economic opportunities and the resulting rents are allocated to stabilise the political system and limit violence. They argue that only a few developed societies have made the transition to *open access orders* that are sustained by rule-based economic and political competition, and the organisation of a broad range of interest groups engaging in state-society bargaining.¹⁹ This transition was powered by an emerging prosperous middle class capable of organising politically and with few exit options.

It is important to emphasise that political and economic development is rarely a neat and linear process. Political change may be gradual or abrupt, and the economic consequences are difficult to predict. Growth may be stimulated by relatively small changes in the relations between different holders of power, such as shift in political rhetoric that provides investors with renewed confidence. A significant recent example of this is the experience of China in the 1980s, where top level political support combined with informal relationships that effectively substituted for more formal property rights produced phenomenal growth despite the lack of formal legal institutions. Political arrangements that serve growth well at one point in time, may prove harmful later. For example, close government-business relationships may initially foster dynamism, but later degenerate into anti-competitive crony capitalism.

There is broad agreement among social scientists about the importance of a political process of state-society bargaining in helping to build public institutions that are both more capable and more accountable. However, it is also important to note that the external environment facing poor countries today differs in significant ways from the circumstances in which state building took place in Western Europe, and has on the whole made the process more problematic:

¹⁹ North et al.(2006) *op cit*. Within the broad category of *Limited Access Orders* the authors distinguish between *Basic LAOs* that have no elite organisations outside of the state and *Mature LAOs* that allow the development of an elite outside of government.

- Whereas in OECD countries institutions tended to develop endogenously through long-term processes of conflict and negotiation between interest groups, in many developing countries modern institutions have been grafted onto existing structures through outside influences. In these settings there is often a wide gap between how institutions are supposed to function, and the reality of everyday experience where informal and traditional practices tend to prevail. The challenge is to build public expectation and trust in the proper functioning of institutions, and to strengthen pressures and mechanisms to hold government accountable.
- The coexistence of very rich and very poor countries in a globalised world. This presents political elites with opportunities to access unearned incomes (e.g. natural resource rents, inter-governmental transfers) and invest these abroad or use them to build a repressive security apparatus with damaging implications for their need and willingness to engage with their own citizens.
- The ability in present times of the skilled and monied middle classes, who would otherwise bring increasing pressure to bear on their political leaders, to move themselves and their capital to more congenial environments, or buy services abroad.
- A country's exposure to the influences of globalisation, in particular the role of direct foreign investors and transnational companies. Larger and more volatile capital flows mean that the rewards and punishments for good and bad policy performance are much stronger.
- The potential of international aid to weaken domestic accountability, impose unsustainable demands on weak administrations and possibly reduce incentives for domestic revenue mobilisation. This needs to be balanced against the potential of aid to support measures that strengthen state-society relations as discussed in section 9.
- The fact the international order and the safeguarding of international frontiers has helped to preserve states that might otherwise not have survived. Political elites have access to powerful military technology and external assistance, which has further weakened dependence of governments on their own citizens. At the same time the international community has become more willing to intervene in internal conflicts often against the interests of the ruling elite.
- The possibility to learn from institutions and role models provided by countries currently undergoing successful growth transitions (China, East Asia Tigers and Eastern Europe), although these are not universally relevant.
- Far greater citizen access to information, especially via the internet, which has served so far to circumvent state control of the media.

7. Political incentives for growth

We have so far explained how growth may be enabled or obstructed by certain types of interaction between holders of power, in particular the relations between those who control political power and the use of force, and those who control private capital. In order to provide a full explanation of politics and growth we need to understand what can transform such interactions into growth enabling relationships. To do this we need to look closely at the incentives and constraints facing public and private agents that affect how they interact and use their power. Their propensity to engage in predation, rent seeking, patronage and looting will depend on political calculations driven by these incentives and restraints. The key questions are in what circumstances do those who control political power have incentives to predate, or allow narrow private interests to benefit from rents and state patronage; and in what circumstances might they have incentives to nurture growth and spread its benefits more widely? What makes it worthwhile for societal groups to organise around broader shared interests in public goods rather than pursue narrow private interests through personal networks? In this section we look closely at the incentives and restraints behind political decision making, and the impact on interest groups.

We conceive of incentives and restraints in terms of two inter-related components: (i) the individual's personal motivations, and (ii) the individual's principal economic and political relationships that in turn depend on the cultural and institutional framework in which the individual is embedded.

The first component draws attention to the importance of the personal characteristics of political leaders that often have a significant influence on economic policy and performance. Reform episodes and growth spurts are commonly associated with a change in political (and/or bureaucratic) leadership.²⁰ In some cases new leaders enact decisive reforms, However, change does not have to be dramatic to start growth, for example a small attitudinal shift towards business can make a large difference to investor confidence.

The individual motivations of political leaders reflect a mix of material and non-material goals. Political agents will generally be interested in opportunities for immediate material gain, advancing their careers and ensuring their own political survival. Individuals will respond differently according to the opportunities and risks generated by the political system, and their subjective attitudes towards these. Political leaders are also influenced by non-material factors, such as status, ideology, nationalism, ethics, beliefs, and religious fervour. Some of these may be compatible with economic growth, while others are not. While many political leaders act venally, others are genuinely interested in development or some other vision. Leadership can make a very significant difference, but its influence is not easy to generalise and predict because individual motivations are complex, sometimes contradictory and

²⁰ For a case study of the political drivers of reforms in Nigeria in the early 2000s and the role of leadership, see Utomi, P., Duncan, A. And Williams, G. (2006) Nigeria - Strengthening incentives for economic growth: The political economy of reform. The Policy Practice Ltd - www.thepolicypractice.com

change over time.

The second component of incentives are the influences on individuals arising from their economic and political relationships. It is important to look broadly at the pressures acting on individuals that may arise from a variety of sources including:

- **Electoral.** How do politicians win elections? To what extent does the need to win votes influence their behaviour?
- **Patronage.** To what extent are politicians beholden to key individuals and groups who helped to get them into power?
- **Economic.** What are the business interests of politicians?
- **Force.** Is there a threat to the regime from within the security forces or rebel forces?
- **Judicial.** To what extent are powerful politicians and businesspeople subject to the rule of law?
- **Civic.** To what extent are politicians beholden to public opinion? How do they respond to public protests? Does the state use its monopoly on violence to repress political opposition?

The following section discusses the factors influencing these pressures and the resulting incentives.

8. Factors influencing political incentives

The factors that influence political incentives tend to be country-specific, and are best understood through in-depth studies examining local political, social, cultural and economic conditions and processes.²¹ However, some general observations can be made on some of the main types of variable that influence political incentives.

Structure of the economy

The structure of the economy has a fundamental bearing on the configuration of interest groups and their influence on political incentives. For example, a smallholder agriculture based economy may not generate the same kind of pressures on politicians to deliver economic growth as a more urbanised and service based economy. There are likely to be strong incentives to liberalise trade in export oriented economies, but much greater resistance in economies based on protected, import-substituting industries. In mineral and oil rich economies there is a particular risk of looting, and in such cases where political leaders can easily plunder natural resources they will face very weak incentives to deliver economic growth.

²¹ There are existing analytical frameworks that can help with this, including DFID's Drivers of Change approach, and the Strategic Governance and Corruption Assessment (SGACA) recently developed for the Netherlands Ministry of Foreign Affairs

Source of government revenues

The source of government revenues is closely related to the structure of the economy. In natural resource rich or aid dependent countries governments gain easy access to revenues without having to rely on taxpayers. In such cases there will be strong incentives to generate growth in the revenue producing sector, but weak incentives to deliver growth in the broader economy. This may result in rampant state predation and looting. Furthermore, where governments do not have to answer to taxpayers public spending is likely to be motivated by patronage rather than growth priorities. The converse may be true in states that must “earn” their revenues by taxing citizens and enterprises. In these conditions there will be stronger incentives to nurture economic growth as a means to increase future revenues, and to establish the administrative machinery to collect and administer tax revenue. The experience of being taxed can mobilise taxpayers and constitute a source of pressure on government for improved performance.²² These links are not, however, automatic, and depend critically on the nature of the tax regime, time horizon of politicians and the ability of taxpayers to organise themselves to demand accountability. Commonly, the political time horizon is very short and taxpayers are weakly organised, if at all. Consequently, wealth capture can be politically more attractive than wealth creation.

Nature of the political system

The nature of the political system, the extent of political competition and the ways politicians gain and hold on to power will have a direct effect on political calculations and incentives. The incentives facing political leaders are likely to vary between autocratic and democratic regimes: the former tending to be more concerned about avoiding unrest and the latter more interested in winning votes. Thus patterns of predation, rent seeking and patronage may differ between autocracies and democracies, although this does not appear to translate into a measurable difference in growth rates. There may also be important differences between various types of democracy. Keefer (2004) refers to research evidence suggesting that patronage spending is more severe in presidential democracies than parliamentary democracies.²³ Differences may also be apparent depending on the degree of proportional, geographical and ethnic representation in the voting system, and whether the basis of political mobilisation is around personal identity and shared economic or livelihood interests that are susceptible to compromise. The ease with which the electoral system can be abused through vote buying, fraud and intimidation will also greatly affect the influence of electoral competition on political calculations; indeed this tends to be the dominant issue in many poor countries.

The use of violence

Political elites seek a monopoly on violence and have a strong interest in preventing other groups from threatening the regime or creating instability by fighting each other. Hence, the capacity and propensity of different groups to organise violence has a strong influence on

²² See IDS (2007) *How does taxation affect the quality of governance?*, IDS Policy Briefing Issue 34, March 2007

²³ Keefer (2004), *A review of the political economy of governance: From property rights to voice*, World Bank Policy Research Working Paper 3315, May 2004

political incentives and growth outcomes. North *et al.* (2006) interpret rent seeking and patronage as a means used by state actors to buy off groups who can potentially threaten the regime. Such arrangements are often harmful to growth, but may avoid violent conflict, which would have even worse economic consequences.²⁴ The incentives facing political elites will depend critically on the potential sources of organised violence including: (i) the military and other security forces, which may or may not be under the full control of political leaders; (ii) violence organised by political, terrorist or mafia type organisations; (iii) warlordism of various types; and (iv) militant trade unions. Political elites will also be highly sensitive to factors raising the risk of conflict (many of which are the result of political and economic processes), in particular ethnic fragmentation, inequality, migration and competition for natural resources. One form of violence with a particularly insidious effect on political incentives is the use or threat of state sponsored violence to deter and repress opposition, to enable predation by politicians and bureaucrats, and to intimidate voters.

Collective action

Organised groups outside of the state can apply pressure collectively on political leaders through non-violent means to pursue shared interests, for example through withholding taxes, lobbying, campaigning, media exposure and street demonstrations. Such influences will be stronger in more developed polities, where there is basic law and order and where interest groups are allowed to organise. However, even where these conditions are weak or absent there will usually be some form of collective action outside of the state, and certain interest groups will be able to influence the incentives facing political leaders.

Collective action can be negative for growth where it leads to extractive rent seeking by small elite groups, but it may be positive where it evolves into a process of bargaining around issues of broader public interest and where there are opportunities for a wide range of non-state organisations to participate.

It is worth noting that the strength of collective action will depend greatly on the incentives facing the interest groups concerned. These will depend on the urgency and importance of the issue at stake, their internal divisions and conflicts of interest, their lobbying capacity and the likelihood that their actions will have an influence on government. Their expectations of this may in turn be influenced by the way in which government is organised, its capacity to implement policy, and the processes by which public programmes are designed and implemented.

²⁴ One example is Nigeria's finely balanced revenue sharing formula that allocates oil generated revenues amongst the 36 state governments. The allocations are widely seen as a massive source of waste and corruption, but have been viewed by the ruling elite as an important way to achieve stability in a large, complex and fractured country.

There are several types of organised groups that commonly seek to apply pressure on political leadership.

- *Business organisations.* The influence of business organisations on the political incentives for growth will depend on whether they are able to lobby collectively in the common interest, or whether they respond mainly to sectoral- and firm-specific interests geared towards rent seeking and limiting competition. Much will depend on the character of the private sector, its diversity and spread of firm sizes and the influence of foreign companies. For example, the existence of a large informal sector will probably result in private sector voice being weak and fragmented. Another important factor is the form of business lobbying, which may be based on *arms length relationships* (open public dialogue) or *hand in hand* relationships (personal contacts between business leaders and high level politicians).²⁵ While arms length relationships are desirable for bringing in a broad range of viewpoints, hand-in-hand relationships tend to dominate in many developing country settings, and are an important explanation for the prominence of *patronage spending* and *rent seeking*.
- *Organised labour.* In many developing countries organised labour is associated with protected industries and public sector employment, and is thus a beneficiary of rent seeking and patronage. These groups are likely to defend vigorously their benefits, and where they are well organised collectively, may often succeed in restraining the ability of political leadership to implement liberalisation measures. But, they also potentially have interests in jobs and growth, and often have political clout, so should not be ignored.
- *Consumer groups.* Consumers groups are a potential source of pressure for greater liberalisation and competition in the economy. However, in most developing countries they are weakly organised. This is probably because there are strong interests defending industrial protection and rent seeking, and the public may not widely perceive the impact on consumer prices. Thus, consumer pressure is usually very limited except in situations where a commodity is vital for a group's prosperity (e.g. the cost of fuel for transporters).
- *Independent research centres.* Where civil society can draw on the research findings of reputable independent researchers, their advocacy will have greater force. While street agitators may be relatively easily suppressed by the state, the reasoned advocacy of respected scholars can be effective in challenging poor government policies and governance abuses.
- *Other civil society organisations and the media.* Civil society and the media can play a key role in exposing acts of predation, generating public pressure for change and ensuring that legal sanctions are put in place. Numerous factors will influence the

²⁵ This terminology is borrowed from Moore and Schmidt (2007) *op cit*.

ability of civil society to organise collectively, including the extent to which they are membership based or have independent sources of funding, general levels of literacy, women's rights, the nature of informal institutions, and the geographical concentration of population. Particularly important is the ability of civil society organisations and the media to defend themselves from attempts by the state to impose control, which may take overt and more subtle forms, including violence, legal measures and cooption through government patronage.

Public expectations of government

There are other important forms of state-society interaction beyond violence and non-violent collective action. Public expectations of government are particularly important and hard to shift when based on a long established record of disappointing performance. If it is widely recognised that government has weak implementation capacity then there will be limited incentives to organise collectively to advocate policy improvements. This may lead to a vicious circle of low public expectations of government, weak policy making and non-delivery. It is difficult to break out of this cycle, but small changes in government behaviour or a widely perceived reform success may be sufficient to raise public expectations of government and create pressure for further improvements in performance.

Keefer interprets this problem of low public expectations and low government credibility as a major explanation for patronage politics.²⁶ In democracies the key calculation made by contenders for political power is whether electoral advantage is best served by policies for broad-based service delivery or by targeting benefits at narrowly defined groups of supporters. This calculation will be influenced by the extent to which political leaders can make credible commitments to voters, implement policies and demonstrate success. Where government capacity is weak, information on policy performance is lacking and voter education is limited, it is much easier for politicians to make credible commitments to provide private goods for narrow groups of supporters rather than towards public goods provision and broad-based service delivery. The problem is both one of capacity (it is harder to put in place policies to deliver broad-based growth than to direct benefits at narrow groups) and of information (beneficiaries of rent seeking and patronage can easily perceive their gains, but the wider benefits of sound economic policies are more difficult to discern).

Competing loyalties between the state and traditional ethnic, kinship and communal ties will also influence public expectations of government and may shift the incentives on political leaders towards dispensing patronage. In societies where traditional ties are strong and identity with the state is weak there is commonly held expectation that politicians will act to deliver benefits to their particular ethnic group.²⁷ This pattern is difficult to break because

²⁶ Keefer (2004), *A review of the political economy of governance: From property rights to voice*, World Bank Policy Research Working Paper 3315, May 2004

²⁷ Ekeh describes African societies as consisting of two public realms. Links to ethnic, communal and local groups are generally strong (the *primordial public realm*), but state-citizen relations (the *civic public realm*) are

these social relationships are deeply embedded and serve the interests of politicians and their constituencies, at least in a narrow sense. Politicians use patronage to buy political support and votes among competing ethnic groups, and groups of voters actively demand that they share in the rewards of the politician they brought to power. In such cases close connections between ethnicity, voting patterns, government patronage are likely to be observed, and will often create marked inequalities in patterns of government spending, service provision and economic development.²⁸

Attitudes of political leaders towards business

The breadth and nature of the business interests of political leaders (and in some cases the military) are clearly relevant to whether they have incentives to nurture growth or to protect their own narrow, short-term interests by placing restrictions on potential competitors. Political leaders with widely spread interests in property and/or capital may be less prone to predation and more concerned with protecting private property rights. However, this protection may be selective. Certain individuals and sectors may be shielded, while others are subject to predatory acts.

Outcomes will also depend on whether politicians regard businesspeople as allies, competitors or threats. Alliances may be formed, for example through business donations to political parties, that act to entrench relations of rent seeking and patronage. In the opposite case businesspeople who are not yet part of the ruling elite may be viewed as a potential threat, and may consequently have their assets confiscated, as has been happening recently in Russia. Such acts may be targeted at individual businesspeople, who may be seen as having political ambitions of their own. Confiscation may also be directed at broader (often ethnically based) sections of the business community, in particular during episodes of ethnic and class conflict.

Nature of the bureaucracy

We have so far emphasised the incentives facing political leaders and the consequences for economic growth. It is also important to understand the workings of the bureaucracy which plays a central role in the formulation and implementation of growth promoting policies, but is also commonly engaged in practices of predation, rent seeking and patronage. The behaviour of the bureaucracy will depend on several factors including its internal discipline and capacity, relations between politicians and civil servants, and the means by which individuals access civil society employment. Fragmented and ill-disciplined bureaucracies are likely to take unofficial payments wherever they can leading to a tragedy of the commons situation that is particularly damaging to investment. However, politicians will usually attempt to control the bureaucracy (for example through partisan appointments) to manage

weak. Unequal participation in the two public realms tends to result in institutions of government being used to serve private, clan or communal interests. Ekeh, P. (1975) "Colonialism and the Two Publics in Africa : A Theoretical Statement", *Comparative Studies in Society and History*, 17(1)

²⁸ See Githongo, J. (2006) *Inequality, Ethnicity and the Fight Against Corruption in Africa*, *International Economic Affairs*, December 2006

predation, rent seeking and patronage and to distribute the benefits according to their own needs. In many cases lower level bureaucrats make common cause with corrupt political leaders, acting as their agents in predatory activities and the sharing of the loot.

Public sector appointments are commonly used as a tool of patronage, in particular where access to secure jobs in the private sector is limited. This will often lead to a large public sector bloated with redundant (or ghost) positions, and a massive waste of resources that might otherwise be productively invested. There may also be intense competition to gain access to lucrative civil service positions where officials can use their discretionary powers to create rents and share the benefits. The nature and extent of rent seeking will therefore depend on how individuals access potentially lucrative positions; whether it is through meritocratic promotion, the purchase of jobs (payments to superiors), partisan appointments, ethnic quotas or other forms of patron-client relationships.

9. An agenda for development agencies

We have argued in this paper that economic growth depends critically on the relationship between the holders of political and economic power, and the incentives facing these actors. Development strategies are not likely to succeed unless they take full account of these factors. Development agencies must therefore base their approaches on a thorough understanding of political incentives (section 7) and the factors that influence these incentives (section 8). The emphasis needs to be on looking for where there are already local incentives and pressures for change, and seeking ways of building on those to help to push political incentives in a pro-growth direction. There are three main areas that provide points of entry:

- External pressures influencing political incentives.
- Strengthening internal incentives for collective action
- Supporting more constructive forms of state-society interaction

These are discussed in turn in the following sub-sections:

9.1 External influences on political incentives

Incentives are primarily influenced by domestic political processes, but, as Chapter 3 of DFID's 2006 White Paper recognises, external sources of pressure can be very important in influencing local incentives (positively or negatively). Moreover, since these are factors over which donors and their governments have some direct control or leverage, they deserve priority. Points of entry include:

- More determined international action to promote conflict resolution and reconstruction in collapsed states.
- Global and regional trade and investment regimes that support growth and rules

based behaviour. This would strengthen rewards for implementing business friendly policies and enhancing competitiveness.

- OECD action to combat corruption, money laundering and the expatriation of stolen assets. This would act as a direct constraint on corrupt leaders and collusive elements of the private sector. By making predatory activities more difficult this would also shift incentives towards legitimate forms of revenue raising, which would generate stronger pressures for public accountability.
- For the same reasons a priority should be given to increasing transparency and accountability in the extraction and trade of natural resources, for example through the Extractive Industries Transparency Initiative (EITI) and the Forest Law Enforcement Governance and Trade Process (FLEGT).
- Mobilising elements of the diaspora that have been exposed to good international practice and might have influence in their countries of origin.
- Creating links between peer-groups, whether political parties or representatives, or private sector or professional bodies, than can provide a means to exchange good practice.
- Donor conditionality is likely to play a limited role as an external source of pressure. Past experience has shown that recipient governments have often been able to circumvent conditionality, and donors have often been unwilling to enforce it.

9.2 Strengthening internal incentives for collective action

A key theme of this paper is that the demand for better governance must come from the political forces within a country. More particularly, the emergence of a middle class, whose economic interests are aligned with private sector led development can be a potent source of domestic demand for sustained and growth-enhancing reforms. Without losing their focus on pro-poor service delivery, development agencies need to think more broadly about which sections of civil society are most likely to generate political change and what could motivate them to organise. This may require fresh approaches, for example a rediscovery of the importance of higher education and independent research institutes in developing countries, greater engagement with private sector associations, and supporting those political and business leaders willing to champion constructive reform.

There is a wide variety of actors that development agencies can work with to strengthen internal sources of pressure that may shift incentives in a pro-growth direction. The measures below relate closely to the sources of collective action discussed in section 8.

- Nurturing the role of civil society. Donors need to formulate a more coherent and

politically savvy strategy towards strengthening civil society, in particular those elements with political leverage and a direct interest in promoting growth (e.g. business associations). This requires donors to acquire a thorough understanding of the nature and quality of local civil society organisations and the context in which they are operating. Donors already provide significant support to civil society organisations, but this is often provided in an *ad hoc* manner that is not adequately informed by an understanding of the interests and incentives facing civil society organisations and the ways in which they engage with the state. They should not assume that the underlying problem is necessarily a lack of resources and organisational skills that donors can supply directly; the obstacles to more effective collective action may be internal fragmentation or low expectations of an effective government response. They also need to be alive to the potential risks of external intervention in creating dependency, limiting scope for local experimentation, and weakening internal legitimacy.

- Supporting the emergence of responsible advocacy NGOs. These are generally more effective if they already have a strong professional reputation for quality service delivery. For example, NGOs engaged in the successful delivery of health services are likely to be well placed to raise issues of corruption in the procurement of drugs and medical supplies. This implies that donor support for NGOs should be for both service delivery programmes and advocacy in their area of expertise.
- Assisting professional and business associations and trade unions to strengthen their organisations, especially in the areas of policy analysis and responsible advocacy.
- Training journalists to engage in professional investigative reporting and nurturing independent media, while recognising that the underlying problem may not be a lack of skills so much as a high level of self censorship.
- Helping to generate taxpayer pressure. Tax relationships are key to building public accountability, but have been neglected by development agencies, who provide a ready substitute for domestic sources of revenue. This requires a greater concern with how taxes are raised and administered and the implications for governance. Tax reform including measures to make the tax regime simpler, more transparent, more broadly based and better administered could begin to shift taxpayer incentives (including business) away from evasion towards mobilisation to negotiate and demand improved government performance.
- Supporting reform champions. Political and bureaucratic elites are rarely monolithic. Among their members there are always individuals motivated by considerations of the greater public good, and these individuals often play a pivotal role in promoting change. In supporting reform champions, there is a clear risk that key individuals may lose their positions of influence, and reforms will be difficult to sustain.

9.3 Enabling more constructive state-society interaction

External and domestic sources of pressure and influence on the political and economic elite can help to strengthen or undermine demand for change. Donors need to be much more alert to the impact of their activity at both the global and the country level on local political processes, in particular incentives for state-society interaction. Development aid can influence state-society interactions in several ways, including for example:

- By linking aid instruments and delivery to more institutionalised forms of engagement between the state and broad groups of citizens (e.g. through budget processes, public participation in programme design and monitoring). Volatile aid funding can undermine attempts to build more institutionalised, predictable policy and budget processes, and so reinforce patronage networks. High levels of aid dependency can weaken domestic accountability.
- By changing public expectations of government. Public pressure for improved government performance may be absent where longstanding weaknesses in governance have generated public cynicism towards government and low expectations of leaders. In this context demonstrating some early reform successes may be critical to re-establishing government credibility and creating demand for further growth-enhancing reforms.
- By making available public information on policy performance. Where voters are well informed on government performance it becomes more difficult to sustain narrowly targeted policies and patronage spending. Information, transparency and voter education are key to enabling voters to make informed choices and for politicians to make credible and verifiable commitments to growth enabling policies.

10 Concluding remarks

This paper has presented the case for thinking about economic growth in more political terms. One of the main deficiencies of much theory and analysis of economic growth is that it only considers *what* policies and institutions are required without explaining *how* these come about. In addressing the *how* question we have focused on the relationships between different holders of power and the incentives faced by these actors. Growth processes depend crucially on building institutionalised relations of trust between those who control political power and the use of force, and those who control private capital

The framework put forward in this paper reflects a rethinking of approaches towards growth and good governance. Attempts to transplant OECD institutional models or to fix dysfunctional institutions in developing country settings have generally not met with much

success where they have ignored local circumstances and political processes. The problems of predation, rent seeking and patronage that often constrain growth are rooted in political processes. This suggests that there is little scope to impose institutional quick fixes. The most effective strategy will be to work with processes and pressures that can help push political incentives in a pro-growth direction.

This approach advocated in this paper requires development agencies to be much more aware of political realities and the timescales required for state building. Greater openness is required to unorthodox, hybrid and transitional institutional arrangements that are compatible with local circumstances and politics ('best fit' rather than 'best practice'). The aim should be "to think less about what ought to be happening, and more politically about what is actually happening, what works and why – and build on that."²⁹

This paper has provided a general overview of how politics shapes growth. However, there are many unanswered questions, and points of contention that cannot easily be resolved on the basis of the limited empirical evidence that is available. It is important to emphasise that understanding of the links between political and economic development is incomplete, and that research on these issues needs to be given priority. The broad framework presented in this paper can help make sense of the issues, and identify the questions to ask, but does not provide complete answers. Greater understanding and more effective aid will best be delivered through detailed research on the links between politics and growth at the country level. The annex to this paper presents ideas on how country level Politics and Growth Assessments could be undertaken.

²⁹ Unsworth, S. (2006) *Getting Better Governance: Insights from New Research*, Trocaire Development Review, p17

Annex

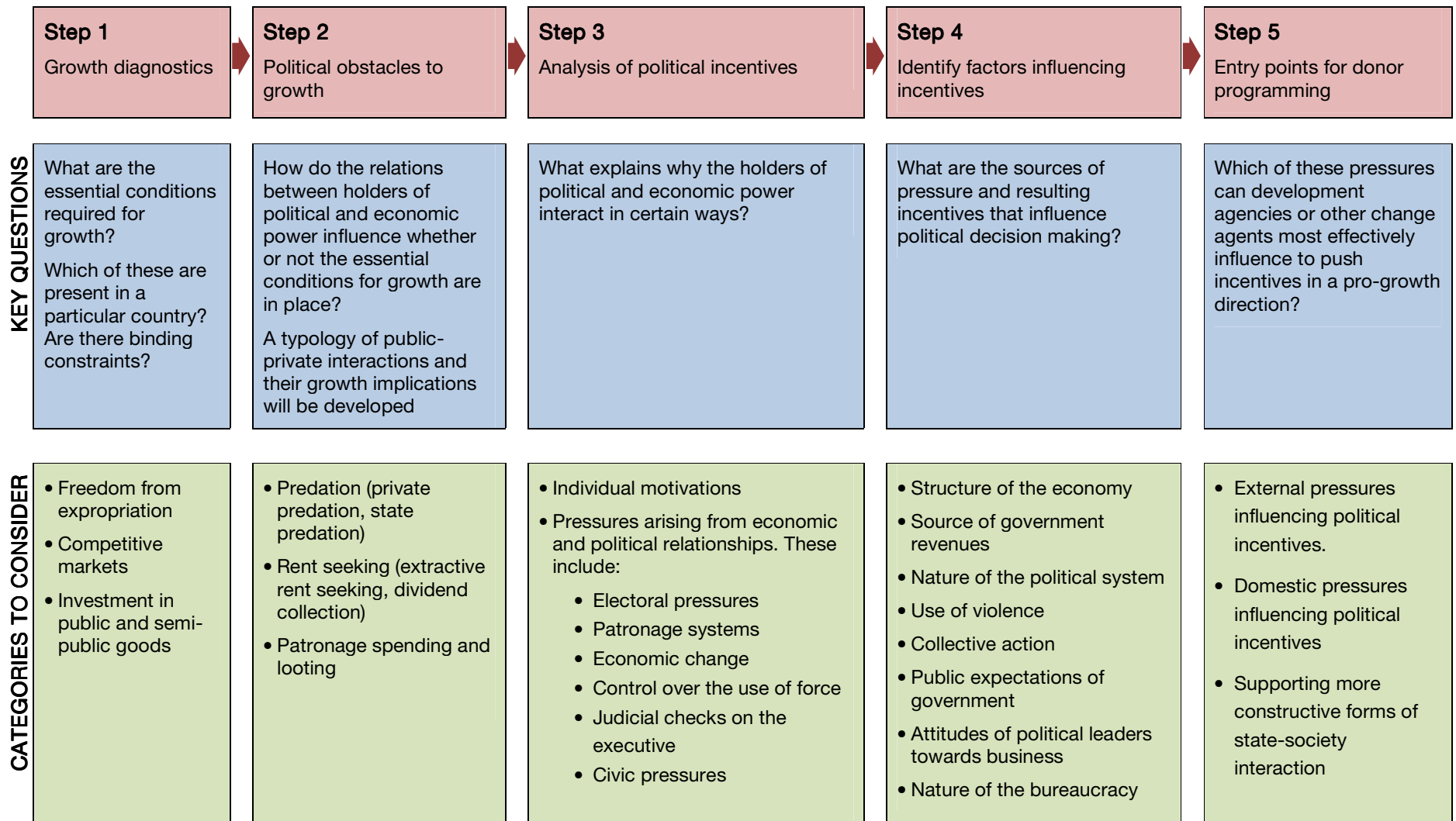
Politics and Growth Assessments

The purpose of this annex is to present some initial ideas on how the general analytical framework set out in the briefing paper could be applied to more detailed analysis at the country level. We refer to this exercise as a Politics and Growth Assessment. The benefits of such analysis would be as follows:

- Politics and Growth Assessments would greatly increase the usefulness of growth diagnostic work. Growth diagnostics have focused on what policy and institutional reforms are required for growth, but have generally not considered how these can be implemented. Politics and Growth Assessments would extend traditional growth analysis to cover the political incentives that may enable or block change.
- Politics and Growth Assessments would have a specific focus on how to generate broadly-shared, long-term economic growth. Improved governance would be seen as a means rather than an end in this regard. Politics and Growth Assessments would be more tightly focussed than most forms of governance analysis, which have often covered a broad range of economic and non-economic objectives.
- Politics and Growth Assessments would improve understanding of how the growth process takes place in a political context. The briefing paper has provided a general framework for analysis, but understanding would be enhanced through the detailed study of country cases.
- Politics and Growth Assessments would help to identify entry points, both in the short- and long-term, where external actors, including development agencies, can support processes that shift political incentives in a growth enabling direction.

Politics and Growth Assessments would essentially follow the stages of the analysis set out in the briefing paper. These are presented in the matrix overleaf. The remainder of this annex provides some notes and guiding questions for each stage of the analysis. It is important to stress here that the political assessment needs to be grounded in a thorough in depth political analysis of what drives the behaviour and decisions of the key stakeholders, taking full account of the socio-cultural context in which they are embedded. This note presumes that for each country this background analysis will be available.

Stages of the Politics and Growth Assessment



Step 1 – Growth Diagnostics

The politics and growth assessment begins with a growth diagnosis to assess which of the basic conditions for growth have been met, and where are the remaining obstacles. The diagnosis covers the three broad categories of constraint referred to in the briefing paper:

1. Freedom from expropriation – investors need confidence that they will be able to retain their assets and an adequate share of the proceeds.
2. Well functioning, competitive, appropriately regulated and internationally open markets operating in stable macroeconomic conditions, and
3. Adequate and appropriate investment in public and semi-public goods, in particular infrastructure, human capital and technology acquisition, that would be underprovided by the private sector.

Within these broad categories the growth diagnosis attempts to identify constraints at a more specific level. For example, if the underprovision of public goods is identified as the broad constraint the diagnosis would need to specify which kinds of public goods are missing, for example energy infrastructure.

The growth diagnostic needs to assess the relative importance of different growth constraints. The aim should be to identify the “binding constraints to growth” (see Hausmann, Rodrik and Velasco, 2005) which are the most significant factors holding back growth at a particular point in time.

Questions to guide the analysis:

- What does the pattern of economic growth tell us about the binding constraints? Growth will occur fastest in areas that are least intensive in the binding constraint.
- Which production factors offer the highest returns? For example, very high returns to skilled education would suggest that education is a binding constraint. Very high interest rates would suggest the availability of finance is the binding constraint?
- What types of firm are most successful? How do they achieve this? The most successful firms are likely to be in areas less affected by the binding constraints.
- What do investment climate surveys reveal about what firms identify as their main constraints? Are there *Doing Business* type surveys in existence that assess the regulatory burden (how long it takes to register a firm, carry out a land transaction etc.)?
- What insights do value chain analysis offer on particular market failures and competitiveness constraints?
- What is the situation regarding the rule of law? Can contracts be enforced? Is the judiciary independent and impartial and is their reliable honest law enforcement?

Step 2 – Political Obstacles to Growth

The second step in the politics and growth assessment links the identified binding constraints to political obstacles (predation, rent seeking, patronage). For example, if the risk of expropriation is considered to be the binding constraint this would suggest that the political analysis should focus on problems of predation. The following matrix lists the different forms of political obstacle to growth, diagnostic signs and questions to guide further analysis:

Conditions for growth	Political obstacles	Diagnostic signs	Questions to guide further analysis
Freedom from expropriation	Private predation <i>(one private agent steals from another)</i>	<ul style="list-style-type: none"> • Firms spend a large proportion of turnover on private security • Existence of widespread insecurity and lawlessness. • Very high insurance premiums 	<ul style="list-style-type: none"> • Is predation related to criminality, ethnic strife, religious conflict etc? • To what extent does government control its territory? • Who is protected by the security services, who is not?
	State predation <i>(holders of public office steal from private agents)</i>	<ul style="list-style-type: none"> • Predatory acts reported in corruption surveys, media etc. 	<ul style="list-style-type: none"> • Which public agencies are most responsible for predatory acts? • Who are the targets? Informal sector, powerful business people? • Which sectors are most prone to predation. Which are protected? How does this relate to the interests of political leaders ? • Where do entrepreneurs have confidence to invest and where are they most wary of government?

Competitive markets	Rent seeking <i>(capture and exploitation of public regulatory power by private interests)</i>	<ul style="list-style-type: none"> • Widespread market distortions • Lack of competition in affected markets 	<ul style="list-style-type: none"> • Which are the most important sources of rents. How does this relate to the interests of political leaders? • How are rents used? Reinvested? Moved offshore? • What are the business interests of politicians? How do politicians relate to the business people? To what extent are relationship personalised or arms length? • How are political parties financed? How do businesses benefit from political donations? • Who in the bureaucracy benefits from rent seeking? How are the proceeds shared? How do officials gain lucrative positions in the bureaucracy?
Adequate investment in public and semi-public goods	Patronage spending <i>(directing public spending into private hands)</i>	<ul style="list-style-type: none"> • Large scale, wasteful public expenditure, mainly directed at private goods provision and narrowly targeted groups 	<ul style="list-style-type: none"> • Which groups are the main beneficiaries of patronage spending? Is this based on ethnicity, religion, political party affiliation etc? • What are the main tools of patronage? E.g. subsidies, public sector employment.
	Looting <i>(holders of public office steal public resources)</i>	<ul style="list-style-type: none"> • Uncontrolled exploitation of natural resources • Lack of transparency in minerals sector • Discrepancies in public accounts 	<ul style="list-style-type: none"> • Where are the main sources of looting? Mineral sector, forestry, public accounts? • Who are the main beneficiaries? Military? Politicians? • How are the proceeds used?

Step 3 – Analysis of political incentives

Having identified the binding constraints to growth and linked these to political obstacles, the next stage of the assessment is to explain these constraints in terms of the incentives facing the holders of political and economic power. Key questions to consider are:

- Why do the holders of political power engage in predation, rent seeking and patronage instead of nurturing growth?
- What makes it worthwhile for societal groups to organise around broader shared interests in public goods rather than pursue narrow private interests through personal networks?

Incentives can be understood in terms of two inter-related components: (i) the individual's personal motivations, and (ii) the individual's principal economic and political relationships. The first component may be largely hidden, but certain characteristics of political leaders may provide an indication of their personal motivations - for example, whether they are primarily interested in self enrichment, staying in power, furthering the interests of their ethnic group, national development etc. In order to understand the second component it is important to look broadly at the pressures acting on individuals that may arise from a variety of sources including:

- Electoral pressures. How do politicians win elections? To what extent does the need to win votes influence their behaviour
- Patronage pressures. To what extent are politicians beholden to key individuals and groups who helped to get them into power?
- Economic pressures. What are the business interests of politicians?
- Military pressures. Is there a military threat to the regime? Does the state use its monopoly on violence to repress political opposition?
- Judicial pressures. To what extent are powerful politicians and businesspeople subject to the rule of law? Can they escape justice? Are there any active investigations against powerful individuals, or is impunity the norm?
- Civic pressures. To what extent are politicians interested in public opinion? How do they respond to public protests?

Step 4 – Factors influencing incentives

This stage of the analysis would consider that factors that influence political incentives and could push them in a pro-growth direction. Guiding questions include:

- *Structure of the economy.* What is the structure of the economy and how does this influence the configuration of interest groups? Which sectors are dominant in the economy, and do these have a strong political voice? How important is natural resource extraction in the economy, and which actors are involved in these sectors?
- *Sources of government revenue.* What are the sources of government revenues? Are these derived principally from “unearned sources”, including natural resource extraction and foreign aid? What is the buoyancy of tax revenues (i.e. how connected are they to economic growth)? Is there a sense of taxpayer pressure? Are taxpayer interests organised in any way?
- *Political system.* What is the type of political and electoral system? What is the degree of proportional, geographical and ethnic representation in the voting system? Can the voting system easily be manipulated and abused? Is the basis of political mobilisation around personal identity or shared economic or livelihood interests that are susceptible to compromise? What is the influence on political calculations?
- *The use of violence.* Which groups can threaten the regime militarily, or create instability? What strategies do political leaders use to contain the risk of violence? What factors raise the risk of violent conflict (e.g ethnic fragmentation, inequality, migration and competition for natural resources)?
- *Collective action.* Which are the most important organised groups in society. Do they represent a broad range of interests or narrow elite groups? Can they apply pressure collectively on political leaders? What strategies do they use? Is collective action mainly directed at rent seeking by small elite groups or issues of broader public interest?
- *Public expectations of government.* Can governments make credible policy commitments to citizens? How strong are public expectations of government performance? Does this influence their ability and willingness to mobilise? How strong are traditional ethnic, kinship and communal ties in relation to identity with the state? To what extent are politicians expected to reward the groups that brought them to power? Is there a close relationship between ethnicity, voting patterns, government patronage and inequalities?
- *Attitudes of political leaders towards business.* What are the business interests of political and military leaders? How does this affect their behaviour? Do politicians regard businesspeople as allies, competitors or threats?
- *Nature of the bureaucracy.* Is the bureaucracy fragmented or well disciplined? To what extent is it controlled by politicians? How are the proceeds of predation, rent

seeking and patronage shared between the bureaucracy and polity? How are public sector appointments made?

Step 5 – Entry points for donor programming

The Politics and Growth Assessment should be relevant to donors' operational needs and should aim to provide clear recommendations country strategies and programming. Key questions to consider include:

- Does the Politics and Growth Assessment challenge current priorities for donor support? Country programmes and portfolios should be screened against criteria established through the Politics and Growth Assessment.
- What level of influence do donors have in the country concerned? What other external actors have political influence?
- What are the particular local sensitivities regarding donor influence? Are there no-go areas or subjects where development agencies need to tread particularly carefully?
- What should be the general thrust of the strategy in terms of: (i) external pressures influencing political incentives, (ii) domestic pressures influencing political incentives, (iii) supporting more constructive form of state-society interaction.
- Within these general areas what specific measures can be proposed? Which measures stand out in terms of the level of donor influence and leverage on growth?
- Do issues of donor coordination present particular opportunities and challenges for implementing a politics and growth strategy?

The donor assistance strategy will most likely continue to contain projects relating to both improving infrastructure and public service delivery, as well as programmes to strengthen institutions and governance. However, it is imperative that the design of such projects and programmes, and the institutional arrangements for their implementation, should take full account of the social and political economy analysis discussed above.