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ESID Briefing No. 10 (Research Framing Paper No. 4)

Researching the political economy determinants of economic growth: A new conceptual and methodological approach

THE APPROACH:

- Moves beyond a focus on 'what' policies and institutions are conducive to inclusive growth, and towards analysis of 'how' political processes shape the emergence and maintenance of these policies and institutions.
- Provides a new framework for analysing the political drivers shaping transitions between economic growth regimes. For the first time, this separates out analysis of the political drivers of growth acceleration from those of growth maintenance.
- Enables exploration of the reasons why growth both accelerates from stagnation/crisis to stable/ miracle growth, and may decelerate/collapse at any stage of stable/miracle growth.
- Facilitates investigations into why some countries persistently remain in miracle/stable growth regimes, while others suffer growth collapses.

Understanding significant differences in growth trajectories and living standards across countries is one of the most critical endeavours of development research. Long-run growth averages within countries often mask distinct periods of growth success and growth failure. Massive changes in economic growth are common in developing countries, with most having experienced distinct episodes of growth acceleration, deceleration and/or collapse, leading to staggering income gains and losses over relatively short periods (Pritchett *et al.*, 2014).

The large existing literature on the determinants of economic growth has traditionally focused on understanding its proximate determinants and, in particular, the role of human and physical capital accumulation, technological change and productivity growth, with an increasing interest in the role of institutions. A very recent literature now recognises the political determinants of the character of such institutions. This literature has attempted to understand why, in certain political contexts, growth-enhancing institutions emerge, and why we see the persistence of growth-impeding institutions in many developing countries for long periods of time (Acemoglu, Johnson and Robinson, 2005).

The new approach presented here contributes to the literature on the political determinants of economic growth in two significant ways. Firstly, it seeks to generate understanding about the political drivers of the frequent shifts in growth rates that developing countries witness over time. (This differs from the focus of much of the existing literature on the empirics of growth, which looks at differences in long-run growth rates across countries.) Secondly, the conceptual framework facilitates the testing of a series of hypotheses which emerge from the wider literature on the politics of growth. Much of the previous literature has concentrated on countries which have experienced persistent 'miracle growth'. The hypotheses tested through this approach focus on understanding the political drivers behind the transitions between growth regimes (Kar *et al.*, 2013a, b) – that is, both countries which make the move from stagnant/crisis growth to miracle growth and countries which make the transition from negative growth to stable growth.

UNDERSTANDING GROWTH REGIMES

Sen (2013) characterises the different phases of growth or growth regimes that developing countries may experience at different times in the following terms (also see Figure 1):

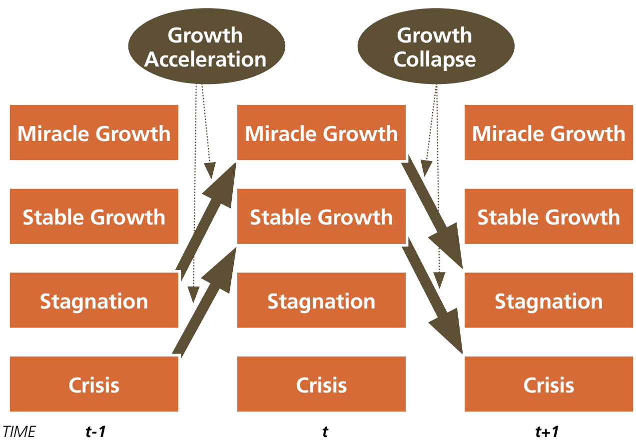
Growth Regime 1: Growth Crisis – negative growth rates.

Growth Regime 2: Growth Stagnation – near zero growth rates.

Growth Regime 3: Stable Growth – moderately positive growth rates.

Growth Regime 4: Miracle Growth – high growth rates (7 percent or over per annum).

Figure 1. Transitions between different growth regimes



Source: Sen (2013)

Figure 1 makes clear that a complete characterisation of the growth process in any particular country requires an understanding of two groups of factors: firstly, those that lead to growth acceleration (that is, the transition from stagnation or crisis to stable growth or miracle growth); and, secondly, those that lead to the avoidance of growth collapses and the maintenance of positive growth (that is, the ability of the country to stay in stable growth or miracle growth in consecutive periods).

THE FRAMEWORK

The conceptual framework we use to explain transitions between growth regimes is based on Sen (2013) and Pritchett and Werker (2013). It addresses two core questions:

a) What are the institutional and political determinants of growth accelerations?

b) What are the institutional and political determinants of growth maintenance?

In our framework, the explanation of growth acceleration is the emergence of repeated personalised relationships between political and economic elites, which we call 'deals'. We define a deal as:

> 'a specific action between two (or more) entities in which actions are not the result of the impersonal application of a rule, but rather of characteristics or sanctions of specific individuals which do not spillover with any precedential value to any other future transaction between other individuals' (Pritchett and Werker, 2013: 45).

An 'ordered deal' is a deal that is honoured, once negotiated between investors and state officials. A "disordered deal' between investors and the political elite is where there is no certainty that the deal will be delivered. Economic growth is likely to accelerate when there is a movement in the deals space from disordered to ordered deals.

What explains the ability of the economy to stay in a positive growth process and for growth not to slow down or collapse? To understand this, we define 'open deals' as deals that are widely available to all investors, large or small, and not confined to an elite or a small group of favoured investors (Pritchett and Werker, 2013). In contrast, 'closed deals' are offered by the political elite only to a small group of investors. The move from growth acceleration to growth maintenance would depend on the movement in the deals space from closed ordered deals to open ordered deals.

Figure 2. The deals space

		Closed deals	Open deals
Kickstarting growth	Disordered deals	Only those with political connections can make deals, and even they cannot be certain that officials will deliver.	Anyone can make a deal, but no-one is certain that officials will deliver.
	Ordered deals	Only those with political connections can make deals, but they can be confident that officials will deliver.	Anyone can make a deal, and they can be certain that officials will deliver.
		Maintaining growth	

Source: Pritchett and Werker (2013)

An ordered deals environment, even if closed, may be able to sustain growth for a considerable period. But for growth to be sustained over the long run, the deals space must – while maintaining order – also become more open. This is because openness in the deals space drives economic competition and facilitates the entry of new firms. This leads to structural transformation, as countries produce more complex products and as resources shift from low to high productivity sectors and firms. Figure 2 sets out the deals space in a 2x2 matrix and shows how it relates to different phases of growth. A shift from disordered to ordered deals is associated with growth acceleration, and a shift from closed ordered to open ordered deals is associated with growth maintenance.

However, there is nothing pre-ordained in the evolution of institutions to suggest that a move from a closed ordered deals environment, or a disordered deals environment, to an open ordered deals environment is linear. As economic growth originates in a country, two feedback loops occur from the growth process to the deals space. These feedback loops can be either positive or negative; in other words, whether with further economic growth the deals space may turn from being open ordered to being closed ordered, or disordered.

The first of these feedback loops is economic in nature, and would depend on the 'rents space', or the structure of economic opportunities in the economy. Figure 3 outlines the rents space in a 2x2 matrix. This categorises the structure of the economy into two dimensions, in terms of whether the sectors in the economy are: in exporting and/or import-competing sectors, or unaffected by international trade; and characterised by high rents (that is, excess profits), or competitive.

Figure 3. The rents space

	High rent	Competitive
Export-oriented	*Rentiers* Natural resource exporters.	*Magicians* Manufacturing and service exporters, other agricultural exporters.
Domestic market	*Powerbrokers* Legislative monopolies or oligopolies, natural monopolies or oligopolies.	*Workhorses* Traders, retailers, subsistence farmers, the informal sector.

Source: Pritchett and Werker (2013)

We call the export-oriented high rent sectors 'rentiers' (the upper left cell), and the competitive tradeable sectors 'magicians' (the upper right cell). We call the monopolistic or oligopolistic domestically oriented or non-tradeable sectors 'powerbrokers' (the lower left cell), and the competitive domestically oriented sectors 'workhorses' (the lower right cell). Rentiers are more likely to be natural resource-exporting sectors; magicians are likely to be export-oriented manufacturing sectors. Powerbrokers are likely to be in real estate, construction, infrastructure, utilities and telecommunications, while workhorses are likely to be smallholder agriculturists and in the informal manufacturing and services sectors.

We would expect firms in the 'rentier' and 'powerbroker' sectors to be more likely to push for closed than open deals; they would lose out in an open deals environment, in which rents dissipate with the entry of new firms, or from more open and transparent regulatory institutions. Since the state plays a large role in allocating licences and controlling the entry of new firms in these sectors, these firms are likely to develop close, personalised relationships with the political elite, to capture the process of licence allocation or to create artificial barriers to entry.

On the other hand, firms in the 'magician' and 'workhorse' sectors are more likely to push for open than closed deals, for three reasons. First, these sectors are the most dynamic, and are where 'creative destruction' is most likely to occur, and firms in these sectors would benefit the most from an open deals environment. Secondly, given the inherent contestability of these sectors and the large number of economic actors, a closed deals space that excludes many of these actors is not likely to find political traction. Finally, these two sectors depend on an efficient powerbroker sector for cheap and high quality inputs to their production process, such as well functioning roads and reliable electricity provision, and would benefit from the competitive pressures on powerbrokers that an open deals environment would bring.

Therefore, if the growth acceleration episode is biased towards the rentier and powerbroker sectors (say, due to a commodity price boom, or the high growth of non-tradeable sectors, such as infrastructure and real estate), the economic feedback loop through the rents space could have a negative effect on the deals environment, making it closed. On the other hand, a growth acceleration episode biased towards the magician and workhorse sectors is more likely to lead to further opening up of the deals space.

The second of the feedback loops would be mostly political in nature, and would depend on how influential groups – such as civil society, the judiciary, the middle class, and the media – view the growth process, as well as how non-elites mobilise themselves against elements of the growth process that they see as politically illegitimate. Particularly in countries with strong civil society presence and electoral politics, the political feedback loop can be negative if the deals environment underpinning the growth episode is seen as exclusionary, or if the nature of economic growth is highly predatory.

The political feedback loop can lead to changes in the distribution of power, as groups such as civil society, the middle class, and those excluded from the growth process begin to gain de facto political power, with greater political mobilisation and pushback from accountability institutions such as the judiciary and the media. Therefore, while a shift from a disordered deals environment to a closed ordered deals environment is often necessary for growth to accelerate, the political feedback effect may turn negative if the deals space remains closed for too long.

If the positive growth episode is underpinned by closed ordered deals that do not become open over time, both economic and political feedback loops are likely to turn negative and the closed ordered deals environment may become increasingly disordered, ending the positive growth episode. On the other hand, economic and political feedback loops can be positive if the deals space becomes increasingly open and the magician and workhorse sectors become increasingly important in the growth process, leading to structural transformation, as new firms, products and industries emerge. In this case, the positive growth episode will carry on, and sustained economic growth will result.

OUR HYPOTHESES

This framework enables us to test four key hypotheses about the political determinants of economic growth across different growth phases:

1. The likelihood of growth acceleration is a function of the move from disordered to ordered deals.
2. The likelihood of growth being maintained, once initiated, is a function of the move from closed to open ordered deals.
3. The commitment of elites to movements in the deals space from disordered to ordered deals, from closed to open deals, and from deals to rules, is a function of the nature of rents in the existing product space. If elites are mostly based in 'rentier' and 'powerbroker' sectors, it is less likely that elites will have an incentive to move from closed to open deals, or to enforce rules. The higher the importance of 'magician' and 'workhorse' sectors, the more likely the emergence of open ordered deals.
4. Negative political feedback loops may occur if deals remain closed for too long, and are seen as politically illegitimate by non-elites. In such a case, positive economic growth may end if there is a shift back from closed ordered deals to disordered deals.

Applying the framework

We are testing these hypotheses through qualitative country case studies as well as quantitative cross-country econometric analysis. Our country case studies are Bangladesh, Cambodia (Kelsall and Seiha, 2014), Ghana, India, Liberia, Malawi (Said and Singini, 2014), Malaysia, Rwanda, Thailand and Uganda. Bangladesh, Ghana and Rwanda are in incipient growth acceleration, India is in growth stagnation, Malawi and Liberia are in recurrent growth collapses, and Malaysia and Thailand are in mature growth maintenance.

WHAT DOES THIS MEAN FOR RESEARCH ON THE POLITICS OF DEVELOPMENT?

- The large existing literature on the determinants of economic growth has focused on 'what' policies and institutions are conducive to growth and, particularly, inclusive growth. We have limited understanding about 'how' political processes shape the emergence and maintenance of these policies and institutions.
- Our conceptual approach enables researchers to fill this gap. It provides an accessible framework for testing hypotheses of the political determinants of inclusive growth. This can assist the pursuit of policy learning about the conditions under which growth emerges, is maintained, and becomes inclusive; or under which growth decelerates and collapses.
- At the country level, our project will help policymakers in our case study countries to better understand the constraints on the maintenance of economic growth, to achieve structural transformation, and to make growth more inclusive.

FURTHER READING

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ABOUT THIS BRIEFING

This briefing is part of a series of ESID framing papers outlining new conceptual and methodological approaches for researching the politics of development. The aim is to operationalise ESID's political settlements approach in specific domains – in this case economic growth – and provide a framework for doing so.

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ESID researchers are based in Bangladesh, Cambodia, Ghana, India, Malawi, Peru, Rwanda, South Africa, Uganda, UK, USA, Zambia and elsewhere.

ESID is led by David Hulme, Chief Executive Officer; Samuel Hickey and Kunal Sen are Research Directors; Julia Brunt is the Programme Manager; and Pablo Yanguas is Research Associate.

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Effective States and Inclusive Development Research Centre
School of Environment, Education and Development
The University of Manchester
Oxford Road
Manchester
M13 9PL
UK

email: esid@manchester.ac.uk

www.effective-states.org