

Governance, Politics and Growth

Kunal Sen
July 2016



In recent years, there has been an increasing realisation that political institutions and governance matter when explaining economic growth in developing countries. Here, political institutions refer to the process of collective decision-making and the checks on politicians and politically and economically powerful interest groups. Governance refers to the capability of the state to provide public goods and how the state intervenes in encouraging or discouraging economic activity by various different actors.

Our first reading is the Commission on Growth and Development's *Growth Report*, which looks at the underlying factors behind rapid and sustained growth in the developing world. It studies the success of thirteen countries that have grown at the annual rate of 7 per cent or more for 25 years or longer. It identifies political factors that have contributed to this rapid and sustained growth, such as a credible and committed government, and strong political leadership, and also highlights economic factors such as trade openness, macroeconomic stability, high rates of saving and investment, and the use of the market to allocate resources.

An important point of debate is whether the strong political leadership necessary for rapid and sustained economic growth is more likely to occur in democratic, rather than authoritarian, political systems. *The Growth Report* argues that rapid and sustained economic growth has been possible in both; in contexts where rival political parties have agreed on a bi-partisan growth strategy that they each followed when they were in power, and also in single party political systems –where the political elite are expected to be in power for a long time and have a long planning horizon. Kelsall (2014) makes a similar argument that democracy alone may not be conducive to economic growth in his assessment of the large-n cross-national statistical literature and the qualitative case study literature on growth successes and failures. He suggests that political factors such as institutionalised solutions to leadership succession, a set of flexible policies that are aligned to the country's comparative advantage in international

Kunal Sen is Professor of Development Economics in the Global Development Institute, University of Manchester, UK, and Joint Research Director of the Effective States and Inclusive Development (ESID) Research Centre. His primary area of research is the political economy of growth. One of his recent books is *The Politics of Inclusive Development: Interrogating the Evidence* (OUP 2014). He has authored 7 books and published over 70 journal articles, including in *Journal of Development Economics*, *Journal of Development Studies* and *World Development*. He has worked on several developing countries, including Bangladesh, India, Malawi, and Thailand.

Reading packs are commissioned by the UK Government's Department for International Development (DFID) for independent study and professional development use. They are intended to be thought-provoking introductions to emerging issues and debates within the subject areas they cover. The views expressed are those of the author, and do not necessarily reflect the opinions of GSDRC, its partner agencies or DFID. © DFID Crown Copyright 2016. Licensed under the Open Government Licence: www.nationalarchives.gov.uk/doc/open-government-licence

Suggested citation: Sen, K. (2016). Governance, politics and growth. GSDRC Professional Development Reading Pack no. 48. Birmingham, UK: University of Birmingham.

trade, and an incipient state capacity in enforcing rules and implementing policies are more important in explaining growth success than the type of political regime.

Should “good governance reform”, such as changing existing rules and regulations that underpin the investment climate in low income countries towards best practice models observed in developed countries, be a priority in a programme to initiate economic growth? Rodrik (2008) argues that “good governance” (or best practice) reforms may not be politically feasible to do, nor have the desired outcomes in many developing countries where the overall institutional context is weak. Instead, it may be better to focus on “second-best” governance reforms that are politically feasible and which may have the desired effects at lower costs of implementation. Hallward-Driemeier and Pritchett (2015) suggest that initiatives which may have minimal impact on the regulatory environment, but signal a decisive shift in policy implementation, could have substantial impact on investor expectations and initiate an acceleration of economic growth (for example, a state commitment to investors not to expropriate their profits).

Our final two readings examine the type of governance strategies that national policy makers and donors may follow to bring about economic growth in a particular country context. Fukuyama and Levy (2010) summarise the strategies as:

- a) State capacity building, via improved public sector performance,
- b) Transformational governance, which are fundamental changes to the country’s political institutions,
- c) “Just enough governance” reforms, where the focus is on growth itself, and in changing the sets of institutions and policies that are constraining growth currently rather than a wholesale reform of institutions, and
- d) Bottom-up accountability, where there is engagement with civil society as an entry point for better state capacity, lower corruption, better public services and improvements in political institutions.

They argue that the decision of which strategy to adopt, and the desirable sequence of the various strategies, are dependent on the country’s economic and political context. For example, “just enough governance” reforms and bottom-up accountability may make sense when a policy maker is trying to initiate growth, while far-reaching changes to state capability and political institutions are required for growth to be sustained.

In a similar vein, Sen (2012) argues that the political drivers of igniting growth are different from the political drivers of maintaining growth. To ignite growth in a stagnant economic environment, the priority of political leaders should be to offer credible “deals” to investors to encourage investment. However, once growth has been ignited, political leaders need to formulate an effective industrial policy that minimises coordination failures in investment and build administrative bureaucratic capacity to deliver public goods such as education and infrastructure in order to maintain growth.

Key readings

Reading 1: Commission on Growth and Development. (2008). *The Growth Report: Strategies for sustained growth and inclusive development*. Washington D.C.: World Bank.

<https://openknowledge.worldbank.org/bitstream/handle/10986/6507/449860PUB0Box3101OFFICIAL0USE00NLY1.pdf?sequence=1>

Reading 2: Kelsall, T. (2014). Authoritarianism, democracy and development. DLP state of the art paper 3. Birmingham, UK: Developmental Leadership Programme (DLP), University of Birmingham.
<http://publications.dlprog.org/SOTA3.pdf>

Reading 3: Rodrik, D. (2008). Second best institutions. *American Economic Review* 98 (2), 100-104.
<http://drodrik.scholar.harvard.edu/files/dani-rodrik/files/second-best-institutions.pdf>

Reading 4: Hallward-Driemeier, M. and Pritchett, L. (2015). How business is done in the developing world: Deals versus rules. *Journal of Economic Perspectives* 29 (3), 121-140.
<http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.29.3.121>

Reading 5: Fukuyama, F. and Levy, B. (2010). *Development strategies: Integrating governance and Growth*. World Bank policy research working paper 5196. Washington D.C.: World Bank.
<https://openknowledge.worldbank.org/bitstream/handle/10986/19915/WPS5196.pdf?sequence=1>

Reading 6: Reading 6: Sen, K. (2012). The political dynamics of economic growth. ESID working paper 5. Manchester, UK: IDPM, University of Manchester.
<http://www.effective-states.org/380/>

Questions to guide reading

- Under what conditions do capable, credible and committed states that can bring about economic growth arise?
- Is strong political leadership with a long planning horizon more likely to occur in single-party political systems than in multi-party political systems?
- Are best practice governance and regulatory reforms necessary for economic growth?
- What should take precedence in maintaining economic growth – building state capacity or fostering democratic accountability?
- Under what circumstances can informal deal-making between political elites and economic actors be growth enhancing?
- What is the quality of the evidence on whether democratisation leads to faster economic growth?