



**What Drives States to Support  
the Development of Productive Sectors?  
Strategies ruling elites pursue for political  
survival and their policy implications**

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**CONTENTS**

Abstract	6
1. Introduction	7
1.1 Why states in developing countries need to support productive sectors	7
1.2 Challenges to studying the political economy of development in Africa	8
2. Why states in developing countries pursue industrial policy	10
3. The Conceptual Framework	15
3.1 Why do states intervene in the economy to support productive sectors?	17
3.2 Why do states choose particular policies to support productive sectors?	18
3.2.1 Degree of vulnerability of the ruling elite	20
3.2.2 Degree of fragmentation within the ruling coalition	21
3.2.3 Size and type of financing to which the ruling elite have access	24
3.3 Why do some state interventions result in better outcomes than others?	27
3.3.1 Industry-political elite cooperation requires mutual interests	27
3.3.2 Ability of the ruling elite to create ‘pockets of efficiency’	29
Conclusions	30
References	31

## **ABSTRACT**

We know a lot about what kinds of policies are needed to support the development of productive sectors, but much less about why governments pursue these policies and why some governments achieve better outcomes than others. The paper reviews the many but disparate arguments on the comparative political economy of development and presents a conceptual approach that builds on the most convincing insights to date. This provides a framework for analyzing why and how ruling political elites support productive sector development and with what outcomes, and for comparing outcomes across productive sectors within and among countries, regions and continents. The approach builds on three propositions: political survival is the key motivation for ruling elites, and the need to maintain ruling coalitions and winning elections shapes the kinds of policies that political elites choose and how they are implemented, in particular whether ruling elites share a mutual interest with relevant productive entrepreneurs and whether ruling elites are able to create ‘pockets of efficiency’ in the bureaucracy in charge of implementing the policies.

## I. INTRODUCTION

What drives states to support the development of productive sectors? Below we begin to answer this question by arguing why state support to productive sectors in developing countries is needed in the first place, and what challenges this poses to studies of the political economy of productive sector development in African countries. This sets the stage for a selective literature review in Part Two centered on scholarly efforts to explain successful economic development. It brings together existing literature in a comprehensible way, so as to contribute to knowledge on the comparative political economy of development. That review, in turn, is used to build the conceptual approach presented in Part Three of the paper.

The underlying motivation for building the conceptual approach was the need for a framework that could be used in researching and understanding the actions of ruling elites to develop productive sectors in Sub-Saharan African countries, under the Elites, Production and Poverty (EPP) research program.<sup>1</sup> We found that existing analytical approaches in the study of Sub-Sahara Africa (hereafter, Africa) were inadequate, and that the comparative political economy of development literature was vast, including many approaches with strong overlaps, but also many approaches that contradicted each other. Therefore, as part of the EPP research program, we set out to create an analytical framework that was more useful in analyzing what we

observed in our African country case studies but which also would allow for comparison across Africa and other developing countries regions.

### I.1 Why states in developing countries need to support productive sectors

Economic development is primarily about overcoming collective action and coordination problems to building competitive productive sectors.<sup>2</sup> For the least developed countries, economic development first requires transforming the productive structure of the country (i.e. structural change) by mobilizing scarce capital and deploying it in more productive ways and channelling labour into economic activities characterized by higher productivity.<sup>3</sup> The key challenge during structural change is socializing risk through low interest loans, tax/tariff incentives, coordinating the provision of complementary assets (e.g. infrastructure, education, etc.), and exposing producers to enough (but not too much) competitive pressure and market discipline. Upgrading or intensive growth requires learning and linkages: learning to operate existing production efficiently, to create new capacity, to innovate products and processes 'new' to the industry and firms, and linking upstream and downstream economic activities.

Most developing countries that transformed their economies and increased per capita incomes significantly did so through

<sup>1</sup> Elites, Production and Poverty is a collaborative research program (2008-2011) coordinated by the Danish Institute for International Studies, Copenhagen. It brings together research institutions and universities in Bangladesh, Britain, Denmark, Ghana, Mozambique, Tanzania and Uganda and is funded by the Danish Consultative Research Committee for Development Research. For more information, see [www.diis.dk/epp](http://www.diis.dk/epp).

<sup>2</sup> For a sample of authors making this point, see Amsden (1989); Noble (1998); Waldner (1999); Doner (2009).

<sup>3</sup> For a review of the literature on structural change, see Whitfield (2011). For an argument that many African and Latin American countries have experience the reverse of structural change in the past decades, in that labor has moved into economic activities characterized by lower productivity, see McMillan and Rodrik (2011).

state interventions that provided and effectively managed incentives for accumulating technological capabilities.<sup>4</sup> Accumulating capabilities does not occur spontaneously within markets, nor can they be easily copied. In contrast, knowing how to use new technologies and methods of organizing work practice to achieve the potential productivity requires investments in learning and actual experience (learning-by-doing). Firms need to go through a learning process to build the necessary capabilities to become competitive in new industries. The learning process can be long and involve financial losses. For private entrepreneurs in developing countries, the risk and costs of investing in this type of learning is typically too high to be worth it, given alternative investment opportunities that are less risky and immediately profitable (Lall 1996; Khan 2009). In sum, the state has played a critical role in the broad processes of structural change and upgrading by facilitating investment of scarce funds in activities whose short-term risks exceed potential but uncertain, long-term development benefits, and by promoting technology acquisition and learning through schemes that compensate for uncompetitive cost structures while learning takes place.

Since technologies vary in their learning needs and collective action problems vary with respect to specific economic activities, state interventions have included industry specific components. The different mechanisms that states have used to do this are broadly subsumed under the term *industrial*

*policy*. This refers to state policies that aim to stimulate specific economic activities (usually involving moving into higher productivity activities) and promote structural change. It is not about industry per se but also includes agriculture or services. Industrial policy includes both ‘functional’ policies that cross sectors (e.g. macroeconomic policies) and ‘selective’ or sectoral policies designed to promote the advance of particular sectors or particular firms.

There is an emerging consensus across economic schools of thought on the necessity of industrial policy, although the details are still debated.<sup>5</sup> As a result, there is increasing effort to change the way we understand ‘investment climate’ in developing countries in order to emphasize the relations and institutions between business and the state that actually facilitate private investment.<sup>6</sup>

## 1.2 Challenges to studying the political economy of development in Africa

Sub-Saharan African countries present a particular puzzle in this context given their generally low technological capabilities and the challenge of achieving structural change and upgrading. African countries generally experienced a stark economic decline in the 1970s that turned into a protracted economic crisis as many countries continued to stagnate into the 1990s. Although, some African countries have had dismal economic performance, many others have experienced high growth in the 2000s (Radelet 2011), but even in the latter

<sup>4</sup> Some of the key works making this point are Amsden (2001), Dahlman et al. (1987), and Lall (1996). Technological capabilities are the technical, managerial and institutional skills that allow productive enterprises to utilize equipment and technical information efficiently. For example, in the area of production, they include production management, engineering and scheduling as well as quality control, increasing productivity and marketing products.

<sup>5</sup> On the need for industrial policy, see Cimoli et al. (2009) and Rodrik (2007), but for debates on the approach that should shape industrial policy see Lin and Chang (2009) and Velde and Lin (2011).

<sup>6</sup> For a review, see Moore and Schmitz (2008).



the accumulation of technological capabilities has been modest. In general, two broad conceptual approaches have dominated scholarship in African studies trying to make sense of Africa's poor economic performance.

One is the neo-patrimonialism approach, which posits that African politics is characteristically neo-patrimonial in nature: political authority is based on patronage, various forms of rent-seeking and prebendalism. Africa's neo-patrimonial politics both caused its economic stagnation and prohibit the state from adopting economic reforms and building developmental institution. Some strands argue that the neo-patrimonial behaviour and attitude of the state elite are important for understanding the political economy of African states; other strands argue that the problem is a larger one of African culture around political legitimacy that hooks these elites into neo-patrimonial relations. These approaches are Africa-specific and emphasize ethnicity, political culture, or the triumph of traditional informal institutions over modern formal ones. As an analytical concept, neo-patrimonialism has been used in so many different ways that its analytical utility is questionable (see Pitcher et al. 2009). In addition, its use is often not supported with empirical evidence showing how it works and its affects on policies and outcomes, but rather states that neo-patrimonialism is the cause based on an analysis of the outcomes. More importantly, neo-patrimonialism cannot explain cases of successful state intervention in the economy (only failures),<sup>7</sup> and it cannot explain variation across countries, or across sectors within the

same country. In particular, it cannot explain why industrial policies are formulated in some sectors and not others, and why they are implemented with more or less success.

The second approach posits that Africa's economic stagnation stems primarily from pursuing structural adjustment in the 1980s and 1990s, now generally referred to as neo-liberal economic policies. According to this line of argument, African countries' have pursued too much neo-liberal reform premised on an idealized model of how markets work. This resulted in the deindustrialization of existing manufacturing and the neglect of increasing agriculture productivity. It did not lead to the spontaneous building of new productive capabilities. Furthermore, international financial institutions and Western aid agencies expanded their influence over policies in African countries, resulting in fragmented authority over policymaking and implementation and a state elite preoccupied with implementing (or perceived to be implementing) donor driven agendas. While the anti-neoliberalism approach highlights the shortcomings of the economic policies prescribed for African countries and their limited outcomes, it over-emphasizes external factors and international relations. In doing so, it neglects the importance of domestic politics in shaping the incentives facing state elites, as well as how foreign aid relations and domestic politics interact.

These two approaches do not provide convincing ways of understanding African countries' generally poor economic performance compared to the rest of the developing world, nor an analytical framework which allows for comparison among African countries (where performance is actually quite diverse and increasingly so) and between African countries and countries in other parts of the so-called developing world. In

<sup>7</sup> Robert Bates (2005) used a rational choice approach to explain economic failures in African agriculture at the time. Although the EPP conceptual framework presented later has some similarities with that of Bates, it is focused on explaining why – and under which conditions – political elites seek to develop productive sectors.

addition, these approaches do not provide analytical tools that can be used to examine state interventions in productive sectors. African studies over the past decades have neglected issues concerning how and why African states have tried to build productive capabilities in the contemporary period. As a result, the empirical material is limited and our understanding is poor.

The comparative political economy of development literature draws heavily on East Asian countries' experiences and to a lesser extent on the experiences of countries in the Indian sub-continent, Latin America and North Africa/Middle East. Sub-Saharan African countries are generally neglected in two ways. They are neglected in the sense that the comparative analyses generally do not include cases of African countries.<sup>8</sup> Africa is also neglected in the sense that Africanist scholars typically do not engage with the concepts and debates in the comparative literature.

But Africa should be not studied separately. Rather, our understanding of Africa can benefit by being seen in a comparative light, and theoretical development can benefit by using African cases. Several key findings from the comparative literature need to be applied in the study of the political economy of development in Africa. Here are three examples, which are elaborated later in the paper. Patron-client relations in African countries can be seen as a distinctly modern form of political mobilization characteristic of all developing countries and not a uniquely African 'traditional' relic from a pre-colonial past.<sup>9</sup> Moreover, corruption may be good for economic development as a means of primi-

tive accumulation; whether it is predatory or productive depends on how the accumulated wealth is used, but what is clear is that accumulation is a necessary step towards building competitive industries. Finally, state support to productive sectors involves the provision of some public goods such as health, education, roads, electricity and water, but it also involves the provision of distinctly non-public goods which benefit specific industries, firms and even individuals.

Fortunately, several other research programs also aim at explaining the political economy of development in Africa based on a comparative political economy perspective. They are looking at the importance of business-state relations and at which kinds of rent-seeking relations lead to better economic outcomes.<sup>10</sup> The approach advanced here shares synergies and moves in the same direction as these research programs, but there are important divergences.

## 2. WHY STATES IN DEVELOPING COUNTRIES PURSUE INDUSTRIAL POLICY

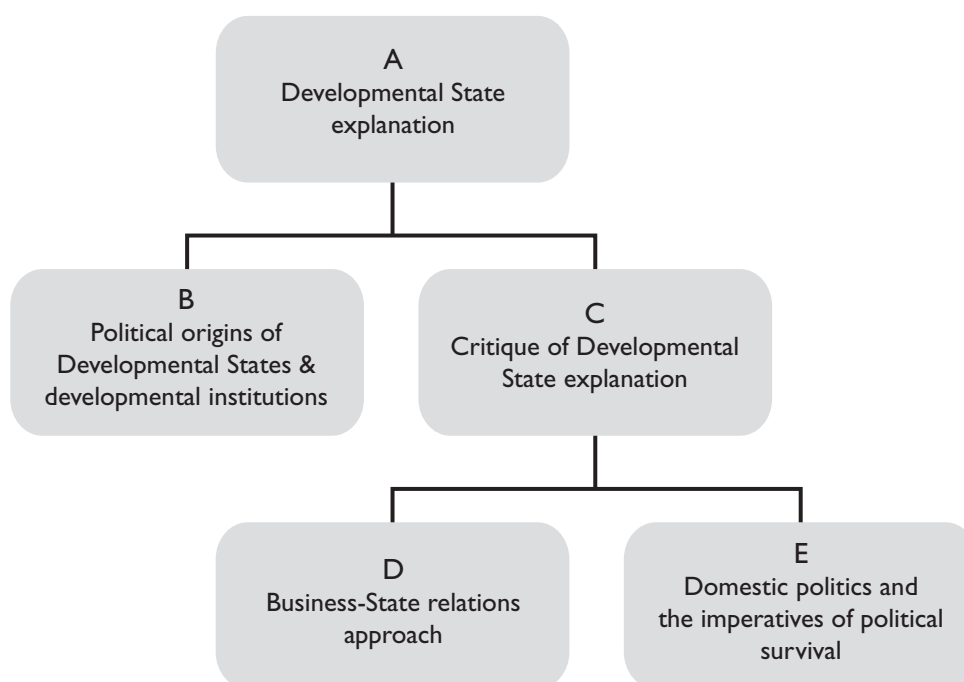
While we know a lot about why industrial policy is necessary, we know much less about why states actually pursue it, exactly what kind of policies they pursue, and what accounts for successful (or unsuccessful) implementation. These questions have been the preoccupation of scholars concerned to explain variations in the success of different developing countries in transforming their economies. It started with explaining the amazing success of Japan and North-

<sup>8</sup> Notable exceptions include Kholi (2004), who includes Nigeria, and more recently Khan (2010), who includes Tanzania.

<sup>9</sup> See also Leonard et al (2010) for a comparative analysis of modern forms of patronage in the livestock sector.

<sup>10</sup> On the Africa Power and Politics research program, see [www.institutions-africa.org](http://www.institutions-africa.org), and on the Improving Institutions for Pro-Poor Growth research program, see [www.ipgp.org.uk](http://www.ipgp.org.uk).

Figure 1. Categories in the Literature on the Politics of Developmental States



east Asian countries, which gave rise to the Developmental State explanation.<sup>11</sup> The research then took divergent paths analytically, as illustrated in Figure 1, as some scholars sought to identify the political origins of the Developmental State while others questioned some basic premises of the Developmental State argument and proposed alternative explanations of the East Asian success based on government-business relations and the political motivations of state actions.

In this section we summarize the diverging paths of this literature and categorize them into different conceptual understandings of what drives states to pursue and successfully implement industrial policy (the categories are

indicated by letters in Figure 1). We highlight overlaps and major divergences, and then argue for what we think is the most convincing approach. Part Three of the paper elaborates on this approach, pulling together insights from various strands in the literature.

**A.** Analyses of the success of Japan and Northeast Asia after World War II emphasized the policies that led to the amazing economic outcomes with an eye to challenging the orthodox policy prescriptions for achieving growth based on neo-classical economics.<sup>12</sup> These works emphasized how states designed policies as well as the institutional characteristics of states that were able to implement such policies. They argued that a determined

<sup>11</sup> Note that we refer to the Developmental State as an analytical construction and not as an actually existing state, and in order to emphasize this point we capitalize the first letters.

<sup>12</sup> For example, see Amsden (1989) and Wade (1990).

technocratic elite within the bureaucracy implemented the industrial policies. These technocrats were able to develop long-term industrial policy because the political elite did not allow distributional pressures from society to undermine economic growth and the political elite sought legitimacy through good economic performance. This category of literature often portrayed the state as a unitary and benevolent actor, which acted relatively cohesively to produce policies and implement them. The public realm and private interests were viewed as clearly separated and the state as pursuing the public interest defined as economic transformation and growth.<sup>13</sup> These analyses begged the question: how did these countries get such good, ‘developmental’ states? Why did the ruling elite pursue such policies and why did ruling elites in other countries that seemingly were also insulated from societal pressures not pursue such policies or implement them successfully.<sup>14</sup>

**B.** To address such questions, some researchers focused on the institutional features that matter for Developmental States, and explored the origins of these institutions shaping the behaviour of state elite (i.e. actively pursue economic development).<sup>15</sup> The approach was generally comparative historical analysis with the aim of generalizing about the political conditions which give rise to ‘developmental’ institutions. These works yielded useful insights as they drew attention to the impor-

tance of the composition of ruling coalitions and to elite configurations that shaped political institutions, which in turn shaped the actions of state elites. The key problem with these works is that they largely accept the explanation about the Developmental State in East Asia and use it as a yardstick for defining what characteristics of states were (and are) necessary. Both the quest for generalizing conditions and the use of the Developmental State conceptualization as a yardstick, gave rise to nice typologies, but ones that did not correspond well with realities.

**C.** New empirical research on the experience of Japan and Northeast Asian countries challenged the ‘statist’ perspective presented above by examining further the political underpinnings of industrialization in East Asia.<sup>16</sup> It disputed the Developmental State explanation on many aspects. First, business had not been a passive actor and did not always do what the state wanted. Business was an independent actor, which shaped state actions and reactions, and the organization of business in specific countries was important for explaining variations in state elites’ actions and the strategies they adopted. Second, close relations between the business and the state were key; their interaction was crucial to the design and implementation of strategies and policies. Recognition of this point gave rise to the soft version of the Developmental State, which was not characterized by state autonomy. Rather, Asian states and business associations were ‘embedded’ in networks of social relations that provided ‘institutionalized channels’ for policy nego-

<sup>13</sup> For reviews of the Developmental State literature, see for example Lauridsen (2008, chapter 4), Leftwich (1995) and Stubbs (2009).

<sup>14</sup> For early critical reviews of the Developmental State concept, which raised these questions among others, see Moon and Prasad (1994) and Haggard (1994).

<sup>15</sup> Literature in this category includes, for example, Waldner (1999), Davis (2004), and Vu (2010). For a review, see Langbehn (2011).

<sup>16</sup> Key works include Evans (1992, 1997), Haggard (1994), Kang (2002), Kohli (2004), Cheng (1990) and Noble (1998). On South Korea in particular, see Chibber (1999) and Lim (1998). For a full review, see Lauridsen (2008: chapter 4).

tiation. Third, relations between the state elite and capitalists were often collusive: state elites extracted money in return for policy that benefited the capitalists. Finally, the idea that a Weberian bureaucracy autonomous from political and social interference was formulating forward-thinking policies that were then implemented was refuted. Rather, policy was heavily influenced in design and implementation by proposals from business and by the political imperatives facing political leaders. Furthermore, even the Northeast Asian states did not have perfect Weberian bureaucracies, but rather 'pockets of efficiency' in key departments dealing with economic issues. Here the administration was insulated from political demands and distributional pressures and focused on economic objectives, while the rest of the administration was affected by patronage appointments and political imperatives to distribute 'side payments' or 'pork' to constituencies within the ruling coalition.

This deconstruction of the Developmental State explanation was carried out by many authors who emphasized different aspects presented above. In a way, they gave rise to two different approaches born from the rejection of the Developmental State concept. The first approach (see category D below) emerged from authors who emphasized the first two criticisms above: the organization of business and collaborative business-state relations. They concluded that an effective development strategy requires a cooperative relationship between business and government (also referred to as growth coalitions or policy networks). The second approach stemmed from the third and fourth criticisms above and led to an emphasis on how state elites' policy choices and implementation, as well as their interaction with business, was shaped by incentives arising from the impera-

tive to remain in power and thus to build and maintain political support and legitimacy (see category E).

**D.** The business-state relations approach was extended beyond Asia's experience to explain the variation in performance of different industries within the same country as well as variation in the performance of the same industry across different countries.<sup>17</sup> Collaborative business-state relations are, it is argued, important for explaining such variations. By collaborative relations, authors are referring to alliances of political elite, industry actors and bureaucrats working together to solve problems for growth and investment.<sup>18</sup> They can be general, but are often industry specific. Such relations require institutionalized access to the state by industry actors, but access can be formal or informal. These coalitions or networks help to solve collective action and coordination problems, facilitate the flow of information and increase the predictability/reduce uncertainty for entrepreneurs. This research maintained

<sup>17</sup> Key works include the edited volumes by Maclyntrye (1994) and Maxfield and Schneider (1997), as well as more recent works by Doner and Schneider (2000) and Schneider (2004). On Sub-Saharan Africa, see Brautigam et al (2002) and Taylor (2007), and more recent work by Abdel-Latif and Schmitz (2010), Sen and Velde (2009), and Seekings and Nattrass (2011).

<sup>18</sup> For example, Richard Doner (1992) introduced the concept of growth coalitions involving the state and private sector in the context of describing the political underpinnings of industrialization in East Asia. Peter Evans' concept of 'embedded autonomy' in the Northeast Asian experience is similar to business-state coalition: 'a project shared by a highly developed bureaucratic apparatus and a relatively organized set of private actors who could provide useful intelligence and decentralized implementation' (Evans 1992: 165). Evans also uses the term policy network in his work on Brazil, where he points to the dense network of ties that were constructed to bind the state and private capital in the petrochemical industry, and how such sector specific policy networks were absent in India (Evans 1992: 172, 174). Kohli (2004: 385) emphasizes that coercive relations can also be an important element of embeddedness.

the central importance of a capable bureaucracy (with meritocratic appointments and technocratic expertise), but emphasized that bureaucrats must be knowledgeable of how industries work and have a shared vision of the industry with businesses.

Students of this approach focus on what kinds of business-state relations encourage collaboration without degenerating into collusion, i.e. rent-seeking relations with negative effects on economic performance, and under what conditions collaborative relations occur. This literature finds that the organization of the business sector is important for its ability to engage effectively on policymaking with state actors: concentration of firms and their structural power; capabilities of entrepreneurs; ability to aggregate interests and act collectively, often through associations. The literature also finds that government actions are important in influencing the collective action of businesses. In sum, state initiative and commitment are very important: ruling elites have to provide business with access to policy and government actions are needed to make business organization strong and solve collective action problems within industries. However, the literature does not explain why ruling elites are willing to engage with business actors and why they engage the way they do.

**E.** This issue is addressed by a different set of researchers, who argue that domestic politics and the imperatives of political survival are important in explaining such state-business engagements. Ruling elites want to stay in power, and staying in power requires building and maintaining a political organization, or what we call a ruling coalition. Consequently, ruling elites make policy decisions with an eye toward sustaining coalitions or persuading opposition members

to change their stances.<sup>19</sup> Partisan politics played an important role in many Northeast Asian countries, and thus the political support base, sources of funding for ruling parties, and the particular electoral institutions shaped the survival strategies pursued by ruling elites. This, in turn, influenced economic policy choices. Even authoritarian leaders were worried about their opponents gaining on them and sought to shore up political support. Exchanging access to policy and state resources is a powerful tool in building and maintaining political coalitions.

Take the example of South Korea, the model Developmental State. David Kang shows that the Korean state interventions reflected the interests of a small group of business and political elites. He argues that 'The production of public goods was often the fortunate by-product of actors competing to gain the private benefits of state resources' (Kang 2002: 6). Diversified business groups exchanged bribes for rents provided through policies pushed by the ruling elite. The ruling elite used these funds to buy political support as well as to enrich themselves. Businessmen used the rents from cheap capital to expand their companies and thus ensure their continued political and economic importance.<sup>20</sup>

<sup>19</sup> For this perspective on the political economy of the Northeast Asian countries, see Noble (1998), Cheng (1990), and Kang (2002). For other authors who take this perspective in general on other developing country regions, see Khan (2010), Doner et al (2005), Ritchie (2005) and Doner (2009) on Asia generally and other East Asian countries; see Geddes (1994) on Latin America; and see Bates (2005) on Sub-Saharan Africa.

<sup>20</sup> So why did Korea's 'money politics' result in good economic outcomes? The balance between the power of economic and political elites and their mutual dependence on each other kept corruption from spiraling out of control. Business groups that controlled a large part of the economy were few, and were organized. The small number of actors, both on the political and the economic elite side, lowered the costs to the rent-seeking process. Security and long term stable relationships secured property rights and encouraged investment. The question is whether the resources will be put

Also in Taiwan policies favoured members or groups of the ruling coalition whose support was crucial to maintaining power. Policies also reflected broader relations with the business sector, but relations in terms of what role capitalists played in maintaining the ruling elite in power. In both of these countries, while popular sectors were politically subordinated and even repressed, the ruling elite were sensitive to any mass unrest and threats to political stability, responding with policy changes and gearing economic performance towards benefiting popular sectors in order to ensure legitimacy.<sup>21</sup>

The premise that ruling elites are motivated primarily by the need to remain in power is shared by much of the literature in category B. It is agreed that what matters most is the context in which ruling elites pursue security of incumbency and political stability and build institutions to meet these goals: this accounts for different institutional outcomes.<sup>22</sup> But what is crucial is the next analytical step of indicating which aspects of the structural context are most important. The marking feature of works in category E is that they emphasize that the composition and financing of ruling coalitions, the nature of electoral politics and representative institutions,

to more productive use. Although the Korean state provided public goods and supported investment, this may not have been why those goods were provided. But society benefited from improved infrastructure, employment and opportunities that accompanied the results of the privileged access of business conglomerates to state capital and policies (Kang 2002). The pact between business and political elites in Taiwan was a mutually dependent relationship similar to that in Korea.

<sup>21</sup> Other factors played important roles during major shifts in development strategy. Eternal threats, constraints and opportunities combined with economic crises to change the broad development strategy (such as import-substitution industrialization, export-oriented industrialization, upgrading in export sectors), but once on a particular path, domestic politics and the imperatives of political survival influenced the specific policy choices of ruling elites (see Cheng 1990).

<sup>22</sup> For example, see Haggard (1994) and Waldner (1999).

and the size and concentration of the capitalist class affect the incentives that ruling elites face in policymaking and implementation. Category E gets into more of the detail about how these things produce outcomes observed by authors in Category B, such as elite cohesion or conflict, the organization of the state, relations between political leaders and state bureaucrats, relations between political leaders and business.

### 3. THE CONCEPTUAL FRAMEWORK

We present a conceptual framework for analyzing why, how and with what outcomes political elites support productive sector development. It is based on the arguments in Category E literature, namely that *we should understand policy choices and implementation by looking at the incentives produced by the formal and informal political institutions characterizing the distribution and organization of political power in a specific country*. On this we draw particular inspiration from the works of Geddes (1994), Kang (2002) and Khan (2010). In addition, we combine this approach with insights from Category D that help to explain economic outcomes and thus what conditions lead to better economic outcomes. The resulting framework shares strong synergies with the framework presented by Moore and Schmitz (2008). As the previous section shows, much of this literature is derived from the experiences of developing country regions other than Sub-Saharan Africa, yet it resonates well with the experiences of sub-Saharan African countries and it has more explanatory advantages than the political economy approaches that have dominated studies on Africa until recently (see Part One above).

Our conceptual framework is presented in the form of three questions:

1. Why do states intervene in the economy to support productive sectors?
2. Why do states choose particular policies and initiatives as the means of intervention?
3. Why do some state interventions result in better outcomes than others?

The questions are inherently linked, and thus so are the answers. By posing them as three separate questions, we present the conceptual framework step-wise, making it clearer. For each question, we summarize the answer in a proposition and then explain it. *Each proposition builds on the previous one.* The first proposition captures our basic premise that political survival is the key motivation for ruling elites in both authoritarian and democratic countries. The second proposition captures how the need to maintain political power shapes the kinds of policies that political elites choose, which sectors they support and how capable they are of implementing such policies. The third proposition captures the key factors shaping relatively more successful outcomes of government policy choices and implementation, as well as the extent to which we can theorize about the conditions under which more successful outcomes occur.

We frame the questions in terms of why *states* intervene to support productive sectors in order to engage with the existing literature on the Developmental State. The word ‘state’ typically is used to refer to governments and specific administrative agencies, as well as the individuals who act on behalf of governments and whose actions and power are derived from their positions in government and who confront different incentives. However, discussions of ‘the state’

in general offer little theoretical leverage for understanding the sources of the competing interests of different actors within the state, which in turn create incentives that shape policy choices and implementation. It makes little sense, therefore, to lump together different individuals and organizations into one concept, since we need to understand how they interact and the logics driving their actions based on their position within the government, the bureaucracy, the political party, the military, and so on.

Instead, the key concepts in the framework presented here are ruling elites and ruling coalitions. By *ruling elites*, we mean the political leaders atop the incumbent regime.<sup>23</sup> By *ruling coalition*, we mean the groups and individuals behind the rise of the ruling elites to power and/or those groups or individuals who gave the ruling elite their support, typically in exchange for benefits. The ruling coalition serves the function of keeping the ruling elite in power by organizing political support, often in the form of patron-client networks.

In sum, the EPP conceptual framework focuses on explaining the political motivations shaping the actions of ruling elites because these motivations are of overriding importance in explaining key features of productive sector policies and their implementation in developing countries. Nevertheless, not *all* variation in economic performance across countries and across sectors within countries can be explained by this focus. To fully account for variations, additional factors need to be added, such as external political and

<sup>23</sup> In the literature, authors use different terms (such as state elites, political elites, political leaders) to refer generally to the same group of people who wield power as a result of their position in government, where they occupy offices in which authoritative allocation decisions are made. We have decided to use the term ruling elite, but the concept is the same.



economic relations. However, we think that the explanation advanced here accounts for most of the variation and is thus very significant.

### 3.1 Why do states intervene in the economy to support productive sectors?

*Proposition 1: Ruling elites support the development of productive sectors when they perceive that this will help them to remain in power.*

Although proposition 1 is straightforward, its implications for policy making and policy implementation decisions are not (Grindle 1991). It posits that political and public office holders are motivated primarily by interest in domestic political survival and advancement. However, people who pursue political power want to do something with it: accumulate private wealth, gain individual or factional benefits, and/or to shape or change the direction of government strategies and policies based on ideas or visions of what should be done. But to achieve these goals, they must remain in power.

Ruling elites across developing countries want the same things: they want political stability, secure incumbency, and rapid economic development for their countries (Geddes 1994; Waldner 1999). However, the need to stay in power trumps all else and affects both political stability and economic development. Ruling elites face what Geddes (1994) calls the *politician's dilemma*: a conflict between their own need for immediate political survival and longer-run interests in economic performance and regime stability. Political leaders may genuinely support some shared set of national goals but still find that the exigencies of political survival

cause them to behave in ways that undermine these goals.

Therefore, the demands of political incumbency pose a powerful constraint, forcing political elite to reconcile the often conflicting logics of politics and economics (Grindle 1991; Geddes 1994). Economic development involves shifting resources among sectors of the economy, geographical areas, and social groups, as well as a temporary shift of resources from consumption to investment. These resource shifts generate opposition and/or support, but a range of social groups may benefit in the long run from them, although in the short run each has an interest in turning economic policy into a distributive game.<sup>24</sup> This point has been well acknowledged, but it has led to an emphasis on the need for state autonomy (insulation from social pressures for distributing resources). However, no set of ruling elites are ever completely autonomous. Rather, it is how coalitional pressures shape the actions of ruling elites that is important. The structure of the ruling coalition determines the political costs of certain policies, as well as the effectiveness of implementing them, given the resistance or support from powerful groups in society (Geddes 1994; Khan 2010).<sup>25</sup>

<sup>24</sup> Distributive games are central to coalitional politics. The more influence and the larger the number of different social groups or individuals, the more demands are placed on the allocation of state resources. If ruling elites try to satisfy all these demands, then 'governing' turns into a distributive game of how to balance claims with the resources available. The incumbent's dilemma captures this well. Pursuing power to accumulate wealth and other objectives, ruling elites find themselves having to surrender their gains to retain political office (adapted from Bates 2008: 40).

<sup>25</sup> Mushtaq Khan (2010: 36-46) makes this point using the concept of a 'growth-stability tradeoff'. Khan's concept of the growth-stability tradeoff posits that productive sectors in developing countries are characterized by growth-constraining transaction costs, and thus supporting higher growth requires interventions that often include changes in institutions or rules. Any particular type of change in rules is likely to have detrimental effects for specific groups, and thus can have what

*Retaining power requires political organization, and political organization requires funding.* Ruling elites seek to build coalitions by extending policy favours that enhance the welfare of particular groups and individuals, and by trading policy influence and access to state benefits for political funds used to maintain their ruling coalition. Patron-client relationships, where a politician exchanges jobs or other favours in return for political support, permeate politics in all developing countries.<sup>26</sup> Politicians, including presidents, engage continuously in the exchange of benefit for political support. Policies providing a range of goods (public, club, or private) are used strategically to ‘buy’ something of value to them (e.g. votes and coalitional support) if the political costs of such ‘buying’ are not prohibitive (Geddes 1994: 183).

The specific strategies ruling elites chose for constructing ruling coalitions, and building patron-client networks, depends on the institutional setting in which they operate and

he calls political transition costs for ruling elites depending on the level of organized political resistance to the implementation and operation of particular institutions. If ruling coalitions cannot absorb or tolerate significant social costs from the groups or individuals that are affected, then they will not pursue those interventions or abandon them during implementation. A growth-enhancing change in rules or institutions is likely to lead to a decline in political stability, but the extent of the decline depends on the political settlement, the rule change or institution in question, and the strategies the ruling coalition pursues in attempting to enforce the institution.

<sup>26</sup> Khan (2010) argues that patron-client networks are a form of political mobilization characteristic of all developing countries that is distinctly modern (see also Leonard et al 2010). The motivations behind patron-client networks constitute a rational response to economic and political constraints in a country where the formal productive sector is too small to define the distribution of power. Geddes and Khan’s use of patron-client relationships is different from the ways in which the terms clientelism and neo-patrimonialism are employed in much of the literature, especially in African studies. They do not refer to a Weberian rational-legal (or ‘modern’) state structure as an ideal type and then argue that what we see in developing countries is a penetration of imported modern state structures by traditional forms of political authority based on personal relationships between leaders and subjects.

the organizational and financial resources they have at their disposal. These political survival strategies affect the policymaking process and how state resources are allocated. Therefore, understanding policymaking requires understanding the political incentive structure within which the ruling elite make economic decisions.

### 3.2 Why do states choose particular policies to support productive sectors?

*Proposition 2: Ruling elites choose policies and implementation arrangements as part of their strategies for maintaining power, in particular for maintaining ruling coalitions and/or winning elections. Such choices affect certain features of the policies that political elites choose, which sectors they support, and how capable they are of implementing them.*

A ruling elite has a range of options of how to provide goods and services to maintain ruling coalitions and win elections so as to stay in power. Policy choices involving allocations of state resources and implementation arrangements are useful tools. Ruling elites can provide goods for individuals, for specific communities or groups in society, and for the general population. The mixture of private, club and public goods provided and how these are implemented and enforced depend on several interacting factors. These factors are explained step-wise below and graphically depicted in Figure 2.

First, the structural and institutional environments in which ruling elites operate are important. Societal and economic structures shape how ruling coalitions are put together because they influence which groups in society have economic power (due to accumulated wealth and the ability to generate wealth as

a result of control over production, extractive resources, or trade) and which groups have organizational power (organizational capabilities, legitimacy, ideology, etc.).<sup>27</sup> These features are historically generated and provide the context in which political elites (or political entrepreneurs aspiring to be part of the ruling elite) seek to build and maintain coalitions and win elections so as to gain and maintain power. Such contexts typically change only slowly, so they can be thought of as given for any particular point in time.

In nominal democracies, formal political institutions also have significant effects on the characteristics of the ruling coalition. Such institutions include electoral rules and systems, rules and practices of political parties, and the rules and practices governing representative organs (legislatures, presidency, etc.).<sup>28</sup> Thus, the increased importance of electoral democracies since the 1980s has had profound effects on the way ruling elites put together their ruling coalitions, because ruling elites have to hold and 'win' elections to maintain legitimacy in the eyes of citizens, as

well as in the eyes of donors in aid-dependent countries. However, even in the context of quasi-democracy and even in the period before the 1980s, ruling elites were responsive to some demands of citizens when devising strategies to maintain political support.<sup>29</sup>

Second, the structural and (nominally) democratic institutional contexts just described shape key characteristics of the ruling coalitions. Three of these are particularly important for us, because they generate an incentive structure that shapes the motivations of ruling elites regarding the use of policymaking and implementation to build and maintain coalitions and win elections. The three important characteristics of ruling coalitions are:

- (1) the degree of vulnerability of the ruling elite,
- (2) the degree of fragmentation within the ruling coalition, and
- (3) the size and type of financing to which ruling elites have access.

Third, variations in these characteristics, and interactions among them within a country or a particular productive sector, affect the types of policies that ruling elites pursue, the implementation of those policies, and ruling elites' capabilities to enforce implementation. Again, the need of ruling elites to maintain their ruling coalition and to win elections have three important effects on choices of policies and implementation – given the characteristics of the ruling coalition – namely:

- (1) the time horizon of ruling elites in choosing policies, by which we mean whether ruling elites aim at quick results and im-

<sup>27</sup> Note that Khan (2010) uses the term holding power to emphasize that the distribution of power in a society is relative. The power of an organization (an organized group of people) is a function of its ability to hold out in actual or potential conflicts against other organizations or the state. Holding power, as he defines it, is a function of a number of characteristics of an organization: its economic capability to sustain itself during conflicts, its capability to inflict costs on competing organizations, its capability to mobilize supporters to be able to absorb costs and its ability to mobilize prevalent ideologies and symbols of legitimacy to consolidate its mobilization and keep its members committed (Khan 2010: 20). While drawing on Khan's understanding of holding power, here we present it in a simpler way, but are referring to economic holding power and organizational holding power.

<sup>28</sup> Mushtaq Khan (2010: 62) emphasizes informal institutions, because he argues that the differences in informal distribution of power characterizing ruling coalitions may be more important for identifying the incentives and limitations of the ruling elite than focusing on the formal political institutions. While we agree with Khan, we also think that formal political institutions in electoral democracies do produce incentives which have significant effects of the behaviour of ruling elite—a point convincingly made by Barbara Geddes (1994).

<sup>29</sup> This point is clear in the cases of South Korea and Taiwan (see Cheng 1990; Noble 1998).

mediate rewards or whether they are willing to pursue policies that do not have immediate benefits but are important for building and upgrading industries.

- (2) the ability of ruling elites to shift the allocation of state resources.
- (3) the capacity of ruling elites to implement or enforce their policies, particularly when they involve a re-allocation of state resources or changes in the ‘rules of the game’

The second and third features are connected. The promotion and protection of a productive sector or industry in developing countries usually cannot take place without changing formal and/or informal institutions or rules of the game (Khan 2000, 2009). Changing the distributive rules of the game is about favouring certain individuals, groups of people or industries over others. Resistance to such changes can have important implications for the political funding or electoral support of

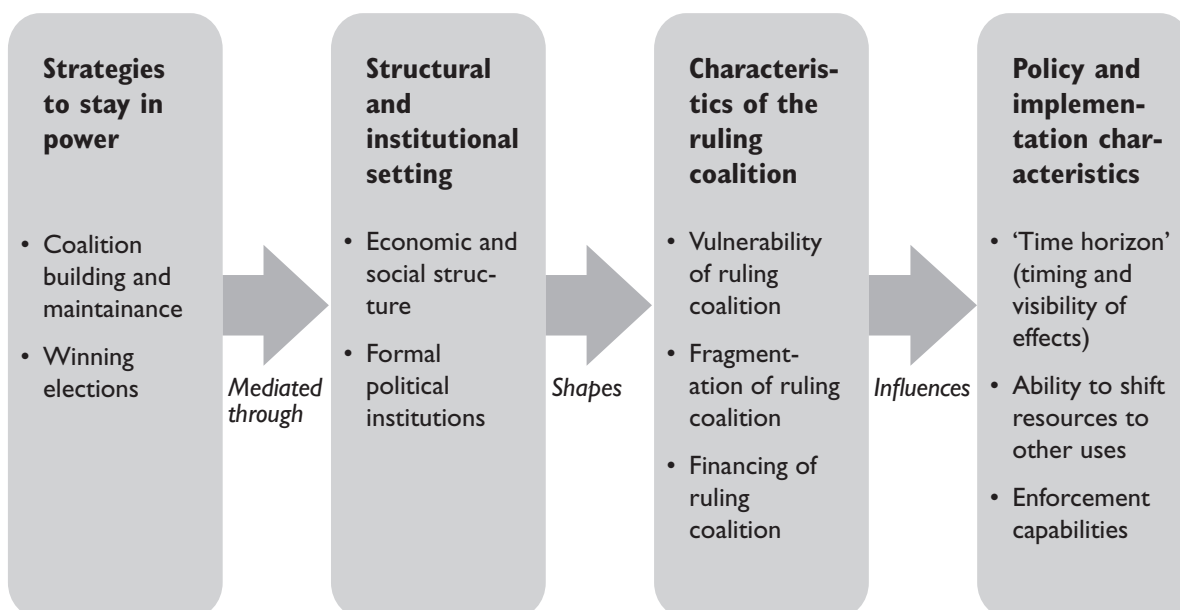
ruling elites. These links between the characteristics of the ruling coalitions and features of policymaking and implementation are elaborated below.

### 3.2.1 Degree of vulnerability of the ruling elite

The security of the ruling elite in power affects the time horizon of ruling elites when choosing policies. The degree of vulnerability of the ruling elite is shaped by the strength of the political factions excluded from the ruling coalition and by the imperative of having to win elections.

Excluded factions can be weak for different reasons (Khan 2010). The most benign possibility is that the most powerful factions have been incorporated within the ruling coalition. Excluded factions may also have weak legitimacy, organizational capabilities or other characteristics for historical reasons. Lastly, excluded groups could actually be strong but

Figure 2. Proposition Two Argument



could be (temporarily) effectively repressed by the ruling coalition.

The relative strength of excluded political factions influences the ability of the excluded coalition to woo or 'buy' supporters from the ruling coalition by offering benefits, the promise of such benefits, or the promise of better livelihoods. That can happen either under democratic or authoritarian rule. Under authoritarian rule, the ruling elite still needs to build and maintain a strong political support base, what some authors call 'political machines' but we refer to as coalition. The likelihood of military coups may also pose a particular threat to the ruling elite.

In electoral democracies, excluded political elites can target both the voters-at-large and loyal members of the ruling coalition by offering better opportunities, thereby garnering more votes at election times. Even if elections are not free, fair and competitive, and even if a country is not a beacon of democracy, excluded political elites may still pose threats to the legitimacy of ruling elites and their hold on power. The greater the threat that an excluded coalition(s) can take away supporters, the more vulnerable the ruling coalition is.

In short, the weakness of excluded factions gives the ruling coalition a *relatively* high degree of stability, potentially allowing it to have a longer time horizon for planning (Khan 2010). In contrast, the greater the vulnerability of the ruling elite in power, the more they concentrate on policies and initiatives that produce *quick results* and *immediate rewards* (Geddes 1994). That is because they are trying to counteract the offers from the excluded political coalition. In electoral democracies, this holds true at the level of the ruling elite collectively, but also individually. If, for example, a legislator is from an opposition party, it reduces his/her access to resources to bring to constituents (in order to

win the next election) and to fulfil individual objectives. However, the degree of vulnerability of the ruling elite is not the only factor, which influences the time horizon of ruling elites. Their time horizon can also be affected by particular kinds of crisis, as shown below in section 3.2.2, and by and state-business relations as shown in section 3.2.3.

### ***3.2.2 Degree of fragmentation within the ruling coalition***

The distribution of power within the ruling coalition between higher and lower level factions, as well as among the higher level factions, influences both the time horizon of the political leadership and their ability to enforce decisions.

Vertical fragmentation (between higher and lower level factions) occurs when lower level factions of the ruling coalition have significant influence over policy choices, because they are important in organizing political support for the ruling elites. This affects the ability of ruling elites to shift resources and enforce policies. Horizontal fragmentation (among higher level factions) occurs when there is a lack of discipline and centralized authority within the ruling elite, as a result of several political leaders or groups of leaders competing for control over the ruling coalition. This affects the ability of the president or a group of high ranking members of the ruling elite to enforce policies that other factions of the ruling elite resist, to shift resources to other uses, and the time horizon of the leadership. Elections influence both of these types of fragmentation, as we also show.

#### ***Vertical fragmentation***

In general, lower factions of the ruling coalition are weaker and in a position of dependence on the leadership of higher level factions.

But there is a significant range of variation from one where lower-level factions have little bargaining power and have to scramble for the attention and recognition of higher level leaders to one where lower-level faction leaders can hold higher levels hostage if their demands are not met.

If the lower level factions on whom the ruling coalition depends are easy to control, then the higher level leadership is able to override internal opposition to difficult decisions and thus is more likely to be able to enforce decisions (Khan 2010: 62). This is because all policies have distributive implications for lower level factions. If they have the capacity to block the implementation of policies unless their distributive demands are satisfied, policies could be blocked or significantly distorted during implementation. On the other hand, lower level factions that benefit from the distributional effects of policies would support their implementation.

The presence of strong excluded factions is likely to increase the bargaining power of lower-level faction leaders over time. In this situation the ruling coalition needs to build strong lower levels in order to provide it with significant organizational power to maintain strong political support and, in nominal democracies, to win election. In this situation, the ruling coalition must also counter better offers of larger benefits from the opposition, which is likely to offer discontented lower-level supporters of the ruling coalition increasingly better offers for defecting (Khan 2010: 64). Even in the absence of strong excluded factions, the need to win elections to maintain hegemonic power could result in strengthening of the lower levels of the ruling coalition.

Once lower level factions become stronger and more numerous, they can constrain the resource allocation decisions of the ruling

elite by placing great demands on benefits they should receive in return for mobilizing political support (Khan 2010: 63). But in cases where lower level factions benefit from the allocation decision, their strength can make enforcement easier for the ruling elites.

### *Horizontal fragmentation*

The source of fragmentation among ruling elites appears to be conflicting individual and collective interests. Individual incentives are produced by the specific position held by the individual: for example, president, legislator, or party leader (Geddes 1994). Legislators depend on re-election, so concern with the vote in the next election always ranks high in their calculations. Presidents want to maximize their future political power within their parties, their chances of re-election, or their influence on who should succeed them. Party leaders pursue career success by maximizing party power and their own power within parties. These individual incentives can come into conflict with collective interests of the ruling elites, such as the survival of the political party (or other type of political organization) in power or their commitment to a particular ideology or national project. Conflicts between individual and collective interests, as well as between individuals pursuing their own interest, are often the source of struggles within the higher levels of the ruling coalition, and can spill over into observable conflicts between party leaders, the presidency/executive, and elected legislators. They result in *competing centres for power within a party*.

For example, in nominal democracies, presidents who face little competition from rivals within their parties and who can count on disciplined behaviour from legislative members of their parties (and coalition allies, in a coalitional government) have more control over the factional and individual demands within

the ruling elite and can generally afford to use some of their power through appointments and allocation of resources to hire experts and build competent agencies. Presidents who lack the weapon of party discipline and have to make deals with and promises to rivals within their parties in order to secure nomination, may have to exchange most of their appointments and other resources for the support of political allies that they need in order to govern effectively (Geddes 1994: 22).

Horizontal fragmentation also results from formal political institutions. In nominal democracies, the number of actors that can block policy decisions and reforms are not only generated by the informal distribution of power in society but also by the formal political institutions, such as constitutions and electoral rules.<sup>30</sup> The greater the number of veto players in a political system, the less 'decisive' it is, meaning a government to less able to make major changes such as major policy reforms and shifts in the allocation of resources. The positive side of a large number of veto players is a larger degree of resoluteness, meaning that once a policy is decided it is unlikely to be changed. Resoluteness can be good for productive sector policies because it creates a 'credible commitment' by government in the eyes of investors. Some balance is needed between enough veto players to instill a credible commitment, but not too many so as to result in the inability to make decisions.

Furthermore, party systems affect the degree of discipline and centralized authority within the ruling party (Geddes 1994; Noble 1998). Particularly important is how presi-

dents and legislators are selected and elected (de Mesquita et al 2005). Certain electoral rules and party systems increase competition between the ruling elite. Increased competition where legislators are selected by lower level organizations of political parties and elected by voters reduces the ability to centralize control within the ruling party.

In sum, the extent of horizontal fragmentation affects the ability of the president or a group of high ranking members of the ruling elite to enforce policies that other factions of the ruling elite resist, to shift resources to other uses against such resistance, and the time horizon of the leadership in choosing policies.

It seems that fragmentation among the ruling elite is the norm, and a significant degree of cohesion among ruling elites in so-called Developmental States only occurred under very specific conditions, which Doner, Ritchie and Slater (2005) refer to a 'systemic vulnerability'. The essence of their argument is that a combination of internal and external crises under conditions of resource scarcity led ruling elites in the Northeast Asian countries to pursue policies to expand the economic pie and create employment as a political survival strategy rather than win political support through redistributing state resources. Whether or not one takes their argument in its entirety, it draws attention to an important point: crises can compel more cooperation among fragmented ruling elite.<sup>31</sup>

<sup>30</sup> The veto player framework was first theorized based on Western countries experiences, but has been applied to developing countries (see Doner 2009; Doner, Hicken and Ritchie 2009).

<sup>31</sup> Doner, Hicken and Ritchie (2009) argue that long periods of this kind of 'systemic vulnerability' as well as scarce resource endowments can create enough pressure to mitigate the inimical economic consequences of fragmented ruling elite. The number of veto players is 'reduced' either by a formal reduction of the actual number of veto players (via constitutional change, coups, party restructuring, elections), by aligning preferences and thus reducing the effective number of veto players, and by relying on delegation of policymaking in order to 'tie the hands' of the ruling elite in order to increase decisiveness of policymaking.

Such crises include threats to national security and perceptions that deteriorations in the living standards of the poorer sections of society could trigger unmanageable mass unrest. When these external and internal threats are combined with a lack of easy access to resources to ameliorate the situation, then the ruling elite are compelled to shift resources to productive sectors and to take a longer-term perspective on the kinds of initiatives needed to build and upgrade industries. It is important to clarify that these are existential threats—threats to national survival or the survival of the elite class, and not the same as insecurity in power of the ruling elite.

Doner, Hicken and Ritchie (2009) argue that long periods of this kind of ‘systemic vulnerability’ as well as scarce resource endowments can create enough pressure to mitigate the inimical economic consequences of fragmented ruling elite. The number of veto players is ‘reduced’ either by a formal reduction of the actual number of veto players (via constitutional change, coups, party restructuring, elections), by aligning preferences and thus reducing the effective number of veto players, and by relying on delegation of policymaking in order to ‘tie the hands’ of the ruling elite in order to increase decisiveness of policymaking.

### ***3.2.3 Size and type of financing to which the ruling elite have access***

Ruling elites use two types of financing in order to maintain coalitions and win elections. First, they depend on state revenues in order to fund the implementation of their policies and on stable flows of foreign exchange in order to maintain macroeconomic stability. Ruling elites also need private investment in order to maintain or increase the rate of economic activity, and thus enlarge the tax base,

increase national wealth and the geo-political or military power of the state, and keep a sufficient part of the population satisfied so that the incumbent government will win the next election and/or face less public dissent (Moore and Schmitz 2008: 36). The higher the proportion of the population depending on formal employment in productive sectors, then the greater is the dependence of ruling elites on capitalists for political popularity. The capacity of investors to withhold this investment is conventionally termed the structural power of capitalists. Bräutigam et al (2008) also show that taxes strengthen state-business relations and bargaining over policies.

Second, ruling elites need revenues that can be used as political funds to pay for the organization of the ruling coalition. Such political funds can come from legal donations or quasi-legal (or even illegal) extraction of resources from businesses in exchange for specific favours (Moore and Schmitz 2008; Kang 2002; Khan 2010). Beyond capitalists, other sources of political funds could include government subsidies to political parties and skimming off state revenue through legal and illegal means (especially in extractive resources, state-owned enterprises and official foreign aid—which are all channelled through the state). In addition, businesses owned by ruling parties or by individual ruling elites can be important sources of political funds.

As a result, the sources of financing have implications for the content and implementation of policy decisions. The firms and economic sectors providing major sources of state revenues and of foreign exchange will be given attention by ruling elites when formulating economic policy and seeking to implement them, and so will individuals or firms that provide significant political funds to finance the ruling coalition. In cases where ruling elites depend on capitalists who are aligned



to the party (through party-owned businesses or because the ruling elite includes important businessmen) the affect on productive sector policies and thus economic outcomes could be either relatively good or bad—depending on the economic activities of interest to the capitalists in the ruling coalition. We elaborate on some of the different scenarios and their impacts on policies and outcomes.

Ruling elites generally pursue the easiest avenues for generating resources (Doner, Ritchie and Slater 2005; Khan 2010). If alternatives to developing new, or reviving or upgrading old, productive sectors are available, it is likely that ruling elites will use them, rather than engage in the hard task of helping domestic entrepreneurs build technology capabilities and creating new institutions for implementing industrial policies. Such alternatives include extractive natural resources (e.g. minerals and oil), official foreign aid to the government, and agricultural commodity exports.<sup>32</sup> Moreover, tax departments may be used to undermine firms and entrepreneurs that belong to excluded coalitions by harassment and extortion.

The more resources entrepreneurs make available for political funds or for state revenue/foreign exchange, the easier it is for them to use such connections to influence policies. On the other hand, entrepreneurs can be politically weak if the ruling coalition can operate without their financial support. If ruling elites have access to sufficient funds outside domestic capitalists (who are not part

of the ruling elite), then these capitalists may be unable to buy into political influence over policies and the allocation of state resources, especially if they are in industries that are not currently key economic pillars for state revenue or foreign exchange. Consequently, their industries will be neglected.

In situations where the ruling elite is not dependent on a domestic capitalist class, or groups of domestic capitalists, for their financial survival, the ruling elite face various incentives (linked to their survival strategies) which shape whether to promote the interests of domestic capitalist. For example, ruling elites may encourage and engage in joint ventures with foreign capital, as individual entrepreneurs or through state-owned enterprises, to avoid promoting the development of an independent local capitalist that might threaten their own rule. This political strategy is evident among ruling elites in oil-rich countries in the Middle East and Vietnam (Moore and Schmitz 2008: 46) as well as in Sub-Saharan African countries. Attracting foreign capitalists may be a particularly attractive strategy when domestic capitalists are small and weak in capabilities and thus foreign capitalists are seen to bring investment, superior technological capabilities, and access to international markets.

To take another example, the stronger domestic capitalists may be concentrated among an ethnic or racial group, and supporting that ethnic or racial group would be a political liability (i.e. exact political costs) for the ruling elite. This situation could lead the ruling elite also to rely on foreign capital as well as to promote capitalists from other (usually the majority) ethnic or racial groups where it is seen to be a good strategy for political survival.<sup>33</sup> To take a final example, rul-

<sup>32</sup> Agriculture commodity exports, referred to as cash crops, in sectors that have existed for a long time (from the colonial or even pre-colonial period) are often important sources of foreign exchange and can be dominant pillars in the economy in terms of GDP and employment. And it is easier to continue exporting such 'raw material' commodities rather than put policies in place to prohibit their export in the current form in order to turn them into higher value exports using process and product upgrading.

<sup>33</sup> The classic example of this situation is Malaysia after 1969 (see Ritchie 2005).

ing elites may create state-owned enterprises or party-owned businesses, as a strategy of off-setting the existing economic power of a group of domestic capitalists, or of trying to control the accumulation process to make sure it does not undermining the political survival of the ruling elite (especially in countries where a strong and independent domestic capitalist class does not yet exist, as just mentioned).<sup>34</sup>

Several countries, especially in Southeast Asia, have had relatively good outcomes from relying on foreign direct investment and export processing zones, rather than support a domestic capitalist class. However, the absence of strong domestic capitalists can have important long run implications for economic development. Multinational companies can flee when economic conditions in the country change (such as rising wages); in contrast, domestic capitalist are unlikely to flee but rather be pressured to move up the value chain or move into a new type of production altogether. Second, the relationship between the ruling elite and foreign capitalists is unlikely to develop the types of business-government relationships that can address the market failures and constraints facing entrepreneurs in developing countries (Wangwe and Arkadie 2000).

In addition to whether the financiers of the state and/or ruling coalition are foreign or domestic capitalists, or whether they come from a specific racial or ethnic group of domestic capitalists, there is another characteristic of capitalists that has implications for policy direction and economic outcomes. The type of economic activity in which financiers

of the ruling coalition are engaged affects what kind of policies they will push for, and thus how resources should be allocated and formal or informal institutions ('rules of the game') be changed or not. For example, capitalists engaged in manufacturing, agriculture, or the import trade will have different interests. Furthermore, capitalists operating in one single sector may have different interests and capabilities than diversified business groups operating across a range of sectors (Schneider 1998; Kang 2002).

Ruling elites' dependence on productive entrepreneurs for political funds and/or state revenues affects the time horizon of ruling elites when making policies. Productive entrepreneurs need stable policies and security of their investment, and thus a 'credible commitment' from the government that it can ensure these two things. They also push government for certain policies to help develop their industries (through the provision of public goods, collective industry level goods or individual firm-level goods), and these will most likely not be the kind of policies that have immediate rewards for other sections of the population.

Lastly, linking to an important point made earlier, economic crises can change the characteristics of the ruling coalition by shrinking state revenue available to ruling elites for building coalitions and winning elections, by reducing foreign exchange earnings, and by drying up political funds. The resulting lack of easy access to resources can affect ruling elites' motivations and how they engage with productive entrepreneurs.

<sup>34</sup> For examples, see Moore and Schmitz (2008) on China and Vietnam, and Abegaz (2011) on Taiwan and Ethiopia. South Korea had an independent domestic capitalist class by the beginning of the 1960s, which was formed largely as a result of access to capital through USAID grants (see Cheng 1990).

### 3.3 Why do some state interventions result in better outcomes than others?

*Proposition 3: Good economic outcomes depend on a) close relations between the ruling elite and the relevant productive entrepreneurs based on mutual interests between them; and b) the ability of the ruling elite to create pockets of bureaucratic capabilities to implement specific policies.*

This final section is a summary of the whole conceptual framework, in that it brings all the pieces together and focuses on the prerequisites for successful state interventions to develop productive sectors. Linking together the arguments in the previous section with the key points raised in the Business-State Relations literature (see Category D, Part Two above), it shows that two key factors are driving good economic outcomes. The first is close relations between the ruling elite and the relevant productive entrepreneurs, which in turn only emerge when both groups have mutual interests in collaborating. But mutual interests are not enough. Second, therefore, ruling elites also have to ensure the necessary bureaucratic capabilities to implement specific policies, and their ability to do so hinges on having enough control over the factional and individual demands within their ruling coalition and over competent and loyal bureaucrats. The Business-State Relations literature emphasizes that capitalists and state bureaucrats are equally important actors for explaining outcomes, and highlights the role of mutual interests and pockets of efficiency in the bureaucracy. However, this literature cannot explain under what conditions these prerequisites emerge. For that, we need to use the arguments from Proposition Two about the motivations of ruling elites.

#### 3.3.1 Industry-political elite cooperation requires mutual interests

To reiterate, close relations between ruling elites and productive entrepreneurs are necessary for state interventions in productive sectors to result in good economic outcomes. This is because policies must address the obstacles that industries face in increasing their competitiveness and upgrading, and they must solve particular collective action and coordination problems among industry actors and between industry and the state. Furthermore, because industry actors (and aspiring entrepreneurs) may be involved in implementing the policies, and must definitely respond to policies with investment and actions taken towards learning, a significant degree of involvement of industry actors in designing state interventions in productive sectors is required. Otherwise, entrepreneurs do not perceive a 'credible commitment' from government and therefore will not respond effectively.

In order for such cooperation to emerge, ruling elites and productive entrepreneurs must have mutual interests (Moore and Schmitz 2008). In other words, ruling elites must need the relevant productive entrepreneurs, and vice versa. In Proposition Two, we argued that ruling elites need capitalists as a major source of state revenues/foreign exchange and of financing ruling coalitions. These two types of financing are necessary for maintaining ruling coalitions and winning elections, and the specific sources of such financing have significant implications for the content and implementation of productive sector policies.

As indicated in Part One, productive entrepreneurs need the active support and cooperation of politicians for a wide range of purposes, such as to supply physical infrastructure, to help ensure adequate sup-

plies of finance and labour, to obtain access to scarce land or natural resources, and to actively support and promote investment by helping firms to overcome collective action problems.<sup>35</sup> Moreover, productive entrepreneurs must perceive the politicians' engagement as credible: that politicians will actually do what they say. This kind of close cooperation between politicians and productive entrepreneurs pursuing common interests can occur even where the overall 'business environment' is poor.

The characteristics of domestic capitalists as well as the organization of particular sectors and industries affect economic outcomes through two channels. The interests of the ruling elites in working with domestic capitalists are shaped by the ruling elites' perceptions of the capabilities of domestic capitalists as well as their importance to the economy (structural power), to state revenues/foreign exchange, and to financing the ruling coalition. How firms organize their collective interests (at a national or sectoral/industry level) and relate to each other is also important. Firms that engage in coordination and with close inter-firm relations are better able to aggregate their interests and form coherent demands on government policy and institutionalize relations in business associations. Such abilities are important for policy decisions and how they are implemented. Sectoral/ industry level associations often play an important role in implementing industrial policies. However, there is an interaction here between business organization and the state. When businesses

organize, they are often reacting to government demands or initiatives, especially the assignment or delegation of selective incentives to businesses which in turn require businesses to organize.

In sum, the nature of the business-state relationship matters for economic outcomes. Mutual dependency of the ruling elite and productive entrepreneurs is important. However, the balance is fragile. Although productive entrepreneurs and politicians stand to gain from cooperation, the relationship is based on each using the other. If one side gains at the expense of the other, then cooperation can break down or, more usually, lead to negative economic outcomes (Moore and Schmitz 2008: 36-37). For example, the close relationship can turn from one of mutual dependence into one of a 'predatory state', where the ruling elite have the upper hand, or 'state capture' where businesses have the upper hand (see Kang 2002).

The turn from mutual dependence to state capture is common. High capability entrepreneurs are needed to drive industries, and in order to do that they must have significant power and thus influence over policy direction, resource allocation, and implementation. However, powerful entrepreneurs can be so influential that they resist changing productive structures and upgrading particular industries, thereby making it difficult for ruling elites to enforce policies with negative effects or sanctions on these entrepreneurs.<sup>36</sup> In short, a business-state relationship that facilitated good economic outcomes at one point the development process, could later stymie further development.

The argument that mutual dependence gives rise to the kind of close relations need-

<sup>35</sup> This point is well-argued by authors such as Sanjaya Lall, Mushtaq Khan, David Waldner, Richard Doner, among others. Moore and Schmitz (2008: 35) do a good job of distilling the main points. For a recent discussion of these points in the context of Sub-Saharan Africa, see the special section in *Journal of Development Studies* on 'Making and Remaking Agro-Industries in Sub-Saharan Africa' edited by Ouma and Whitfield forthcoming in 2012.

<sup>36</sup> For an elaboration of this point and examples, see Khan (2000, 2010) and Doner (2009).

ed to formulate and implement effective productive sector policies applies to the national economy level *as well as* the sector/industry level. In countries with diversified business groups or large conglomerates, it may make sense to look at the national level, as firms act and have interests that cut across sectors. In countries with a different business organization, looking at the sector level makes sense, as political relations between the ruling elite and business can (and do) differ by sector. Therefore, it is often necessary to look at business-state relations at the industry level, because they differ across sectors within the same country and account for variation in outcomes. Of course, to get the bigger picture, we must place industry-specific analyses within a broader understanding of the structure of the ruling coalition and of how it is financed (i.e. within the broader dynamics of business-state relations).<sup>37</sup>

### 3.3.2 Ability of the ruling elite to create 'pockets of efficiency'

The ruling elite make major policy decisions, but state bureaucrats have to implement them. Key to implementation is the existence of effective bureaucratic organizations (Geddes 1994; Grindle 1980). But what is an 'effective bureaucratic organization'? We know from the critical literature on Developmental States, that states do not need to have an administrative apparatus that conforms in its entirety to a Weberian bureaucracy. In other words, the bureaucratic capabilities are not strong across all parts of the state bureaucracy, but rather they appear in pockets. We refer to these as 'pockets of ef-

iciency'.<sup>38</sup> What is important is how pockets are created, and what kind of capabilities are necessary.

First, top ruling elites must have a significant degree of control over factional and individual demands within the ruling coalition in order to create 'pockets' in the bureaucracy free from particularistic demands of higher and lower level factions of the ruling coalition intent on getting scarce state resources in exchange for political support. Too much fragmentation at the horizontal level of the ruling coalition (i.e. within ruling elites) reduces the control of top political leaders. Fragmentation forces top political leaders to focus on keeping the ruling elite coherent by buying off elites or acquiescing to their individual demands; also strong factions within the ruling elite can resist particular policies or their implementation. If the lower level factions of the ruling coalition are strong, then the top political leaders will be less able to resist distributional demands of lower level factions because retaining the support of the lower level factions is critical to their remaining in power. Thus, the less centralized control or authority over the higher and lower level factions, the more difficult it is for political leaders to create pockets within the bureaucracy insulated from the particularistic demands of ruling coalition.

Second, ruling elites must have a significant degree of control over competent and loyal state bureaucrats in order to have 'efficiency' in carrying out the ruling elites' side of the deal with capitalists. Ruling elites drive the major decisions, but bureaucrats have to take decisions in the course of implementation. Therefore, the bureaucrats must have technical knowledge of the sector/industry *and* be

<sup>37</sup> This point is made convincingly by Khan (2010). Increasingly other authors are calling for a sector approach, such as Abdel-Latif and Schmitz (2011) and Breznitz (2007), and notably their work covers a wide range of countries.

<sup>38</sup> On the origins of the term, which dates back to the 1980s, see Leonard (2010: 92).

trusted by the ruling elite. The recruitment of top-level bureaucrats must therefore be based on both merit and loyalty – what Peters (1995: 90-91) calls ‘responsive merit’. It is also important that state bureaucrats and industry actors share a common understanding of the problems that need to be solved.

As a result of the need for loyal state bureaucrats, pockets of efficiency are not permanent but have life spans that depend on the ruling elites remaining in power. The more frequent the turnover of ruling parties (or ruling coalitions), the shorter the life span of pockets of efficiency and the need to continuously recreate them. In countries with large pools of competent technocrats who can be employed, this is not necessarily a problem. In less developed countries, it can be, as the pool to choose from is not very big. Thus, longer tenures of the ruling elites can facilitate building pockets of efficiency (as in South Korea and Taiwan); however, this is a necessary and not sufficient condition (as the case of Tanzania, for example, illustrates). Control of particularistic demands within the ruling coalition is equally, if not more, important.

In sum, implementing policies agreed with relevant productive entrepreneurs requires two things. First, it requires competent bureaucrats, as we define it above. Second, the bureaucrats must have some sort of insulation from particularistic demands of members of the ruling coalition.

## CONCLUSIONS

Although we seek to identify factors and causal mechanisms that can help to explain differences in performance across productive sectors within a country and across countries and regions, there are limits to such gener-

alizations. Successful episodes of productive sector growth over time are the outcome of different combinations of factors and institutional set-ups, as well as different political economy dynamics. That is why, as Cimoli et al (2010: 6) point out, a better understanding of such factors are ‘not likely to be statistically captured by heroic “reduced form” estimations’ in regression analysis made with generalizations and predictions in mind. Grindle (2001: 370-1) make a similar point. Static concepts of power cannot explain institutional change nor why some countries (or sectors) have actually taken off (or collapsed) within fairly short periods. Consequently, to the extent that generalizations are possible for a country or a sector, they are likely to be time specific. We hope that the approach presented in this paper strikes a balance that helps us to make some contingent generalizations and not just lead us astray into ever more detailed analyses of process.

In a forthcoming paper, we will revisit the framework with a comparative analysis of five country studies undertaken as part of the Elites, Production and Poverty research project, highlighting where our empirical research findings can help to elaborate, revise or refute the propositions made in this paper. At that time we will also compare and contrast the EPP conceptual framework and findings with those of the Africa Power and Politics and the Institutions for Pro-Poor Growth research programs.

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