

Political Settlements

Issues Paper

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1. Introduction

Political settlements are defined by the UK Department for International Development (DFID) as “the forging of a common understanding, usually between political elites, that their best interests or beliefs are served through acquiescence to a framework for administering political power”. An inclusive political settlement is one where the relations between the state and society, ‘the social contract’, are robust and legitimate.

The idea that a political settlement refers to a ‘common understanding between elites’ downplays the extent to which political settlements are *bargaining* outcomes among *contending* elites. The most theoretically robust definition of political settlements has emerged from historical political economy, particularly articulated in the work of Mushtaq Khan (1995, 2000), where ‘political settlement’ refers to the balance or distribution of power between contending social groups and social classes, on which any state is based. Looking at the political settlement focuses attention on intra-elite contention and bargaining (political versus economic elites; landed and non-landed elites, regional elites, rural and urban, religious and secular, etc), on contention and bargaining between elites and non-elites (either within groups or across them, as between classes), inter-group contention and bargaining (gender, regional, ethnic/linguistic, religious) and on contention and bargaining between those who occupy the state and society more widely.¹

Political settlements manifest themselves in the structure of property rights and entitlements, which give some social actors more distributional advantages than others, and in the regulatory structure of the state. These settlements, which can take the form of ‘political coalitions’, may be the result of a narrow or forced bargain imposed by authoritarian regimes, the outcome of compromises between previously warring parties, or the result of more pluralist bargaining arrangements, as in democratic regimes. In the long line of thinking in historical political economy, beginning with Marx, analysing the balance of power between contending groups and classes has been central in exploring the formation and change of institutions such as the process of democratisation (Moore, 1966), the transition from feudalism to capitalism (Brenner, 1976), the effectiveness with which industrial policy is implemented (Khan, 1995; Kohli, 2004), and the closely related effort of historical institutionalists to explain the varied routes to capitalist transformation (Hall and Soskice, 2001). Historical sociologists have also deployed the concept in a similar way, for instance Melling’s (1991) analysis of industrial capitalism and social insurance in Britain, where he argues that “the social policies of the state formed part of a wider *political settlement* at key moments of development”, stressing the limits of analyses that focus only on economic and state structures.

Political settlements are shaped by political organisation and these can have a decisive impact on both the consolidation of a settlement – its achievement of

¹ For a definition of ‘elites’, see the discussion of the ‘elite bargain’ below.

resilience – and the extent to which a settlement promotes development-enhancing actions. Historically, political parties have been the most effective types of political organisation as they can develop an ideology and a strategy, but most importantly a disciplined organisation to pursue purposeful action.² They act as a bridge between civil society and the state and can offer ideological justifications for state action and organise societal demands on the state. We review evidence from the literature on the role that political parties play in shaping political settlements and outcomes in the discussion of taxation below.

Determining how inclusive or exclusionary a political settlement is cannot be understood simply by looking at the extent of participation in the bargaining process, or at appointments in the offices of the state. It requires an analysis of the distribution of rights and entitlements across groups and classes in society on which the settlement is based. It is possible that an imposed political settlement can be more inclusive than one reached through pluralist bargaining (as might be argued in the case of South Korea under Park Chung Hee versus the post-independence settlement under Syngman Rhee). As society is formed of contending groups and classes with different interests, the ultimate test of inclusiveness needs to be anchored in the distribution of rights and entitlements, which are the *outcome* of the settlement. Neither is inclusiveness necessarily an attribute more likely to lead to development or even pro-poor social policy (as we discuss below).

This idea of political settlement as a balance of power that represents a bargaining outcome has important implications for the idea of the ‘social contract’. While neoclassical theory uses the Hobbesian contract to describe the state, such an externally enforced cooperative agreement is not democracy. Instead, the state is itself an (albeit imperfect) *agent of coalitions* formed to assure compliance – ‘a pact of domination’ (Przeworski, 1991: 23). As such, a democratic state is neither autonomous nor a social contract, but a bargaining equilibrium or relation amongst relevant political forces. Przeworski, in fact, argues that the notion that democracy is a social contract is logically inconsistent: “Contracts are observed only because they are exogenously enforced; democracy, by definition, is a system in which no one stands above the will of the contending parties”.

² The classic and still authoritative study of political parties is Duverger (1959, p.425) who sees them as oligarchic, hierarchical organisations, capable of forming an “elite sprung from the people”. There is some evidence that the degree of political party centralisation seems to be an important feature of relatively successful pro-poor social service delivery in low-income settings. Sri Lanka, and the state of Kerala in India, for instance, have education indicators that are greater than would be expected for their per capita income (Drèze and Sen 1989: 226-253). Each of these countries/states also possess relatively centralised political party structures that effectively aggregate the ‘voice’ of the less wealthy segments of the population (see also Moore and Putzel [1999] on the importance of the political capacity of the poor to mobilise voice and demand pro-poor social delivery). The Communist countries (Cuba, China, the Soviet Union) also all had very disciplined and centralised party structures, and one of the sources of legitimacy in such regimes was to provide high quality education and health for all. In this sense, the source of state legitimacy and the ideology of the dominant political parties may be a more important factor for delivering high quality public services than whether the regime is more or less democratic.

There are less theoretically interesting uses of the term ‘political settlement’, which are ubiquitous in academic, policy and more popular literature. Most prominently, in peace studies and international relations and related discussions of conflict in the policy and journalist communities, ‘political settlement’ refers to two basic phenomena.³ First, it refers to a resolution reached after warfare, through negotiation rather than violence – one *form* of settlement mentioned above.⁴ Second, it is used to refer to any agreement between contending parties that is peaceful rather than violent. In fact, while historical political economists are applying the concept within a long tradition of studying power relations, the concept does not have a specific ‘pedigree’ in political theory or political science,⁵ though it has been deployed by liberal political theorists.⁶

Understanding the condition of a state by examining the political settlement on which it rests is helpful for several reasons. First, one of the most important insights emerging from the literature is that the ‘design of institutions’ (the rules and norms that govern behaviour), particularly formal state institutions, does not determine either political or economic outcomes. Democratic institutions in one state may be associated with violent conflict and economic stagnation, while in another they may be related to peaceful social relations and economic growth. The argument emerging from the literature is that it is the underlying political settlement which determines political and developmental outcomes. We explore this in the next section, in our discussion of the way authors examining political settlements from the perspective of historical political economy offer a more robust explanation of institutional change and development than new institutional economics on which much of the policy community’s thinking about good governance rests.

Second, understanding the political settlement provides a route to understanding the differential performance of states in the developing world and the directions reform might take when it comes to fundamental state functions. We illustrate this through a discussion of the literature on taxation. The strong performance of Costa Rica or South Africa in raising taxes and deploying revenue for developmental purposes, as well as pursuing taxation reform can be traced to the different character of the political settlements in these countries.

Third, through an examination of the emergent literature on ‘elite bargains’, we suggest that a focus on the bargains which can be found at the centre of

³ Whaites (2008) is the first serious effort to introduce the policy community to the concept as it is deployed in historical political economy.

⁴ The literature employing this use of the term is voluminous as can be seen through a review of *Journal of Peace Studies*, *Journal of Peace Building and Development*, *Conflict, Security and Development*, *International Negotiation*, etc. Lloyd (2001) provides an example.

⁵ A search in *Political Science Abstracts* between 1960 and 2009 identifies only 27 articles that have employed the term “political settlement” in their titles and these were overwhelmingly related to the commonplace use of the term in peace studies.

⁶ Ronald Dworkin (2006, 97) sees political settlements as fixing “the distribution of personal wealth and opportunity in the community” and as embodied in laws and policies. The political settlement sets both the parameters and consequences of choice and as such is foundational to the political system.

political settlements, provides an explanatory framework for understanding trajectories of state fragility and resilience, as well as how these relate to processes of development and poverty reduction. An elite bargain may be durable (or robust) allowing the state to achieve a significant monopoly over coercive force and a basic capacity for taxation and popular allegiance, but in doing so it may block further developmental advances (Putzel and Lindemann, forthcoming).

We deal with each of these in turn and offer two illustrations of the application of the study of political settlements in an appendix at the end. The concluding section offers some brief reflections on how a focus on political settlements may be important for the development policy community.

2. Political Settlements and Institutions

While those working within new institutional economics (NIE) conceptualise state institutions simply as incentive structures, an historical political economy approach argues that institutions incorporate distributional advantages in line with the reigning political settlement. In neoclassical theory, institutions and property rights emerge because they provide incentives for efficient resource allocation. If institutions were simply a set of incentive structures, then it would be possible for an appropriate institutional *design* to improve the growth prospects of a failing economy. The idea that rights specify only incentives is however incomplete. This is because property rights also, by definition, specify *a historically specific distribution of control and authority over assets* (Dahlman 1980, 213-214). Without an analysis of the nature of the polity, it is impossible to know, *a priori*, the legitimacy or enforcement costs of a given structure of property rights. Very high enforcement costs imply political resistance to a particular institutional framework, and are likely to worsen the security of property rights associated with that particular institution. This, in turn, is likely to lower the growth rate of the economy.

In the NIE tradition, North (1990) argues that democracy is the institutional structure most likely to reduce the transaction costs in a polity.⁷ The model introduces the idea of political transaction costs, which are the costs of organizing side-payments (grants or subsidies to interest groups to win their support), which allow institutions to be changed through voluntary contracting. Democracy is the set of institutional arrangements that supposedly lowers political transaction costs the most. Low transaction costs imply easier and expanded access to the political system and an increase in the ability of agents to bargain over changes that affect their welfare.

According to North:

“The efficiency of the political market is the key to the issue. If political transaction costs are low, and the political actors have accurate models to guide them, then efficient models will emerge.” (p.52)

North, in effect, argues that the polity is a set of political institutions that generate incentives for change. It is implicit in the argument that liberal economic markets and a liberal and democratic state promote growth-enhancing incentives. This is the main idea behind the current “good governance” paradigm (see World Bank, 1997).

North (1990, chapters 9-12) applies the model of path dependency to the divergent development paths of England/North America and Spain/Latin America. The basic differences are:

⁷ In NIE, transaction costs “are the costs of finding out what the relevant prices are, of negotiating and of concluding contracts, and then of monitoring and enforcing them”, which were not taken into account in traditional neoclassical economics (Harriss et al, .1995, p.3)

a) Spain/L. America — centralized/authoritarian rule → monopolisation of markets → arbitrary rule → fiscal instability and state appropriation → insecure property rights → relative economic stagnation

b) England/N. America — decentralized, democratic, liberal state → competitive market → stable and predictable fiscal policies → secure property rights → economic growth.

North focuses on the incentive role of institutions. This, however, is incomplete, since institutions and rights also assign privileges and therefore distributional advantages. If institutions, such as democracy, only determined incentives, then all democracies would be similarly wealthy. This is not the case (see Clague et al., 1997).

There is nothing intrinsically efficient about a particular institution. This is why institutions are not easily transferable from one context to another (the classic transferability problem in development). Thus, while North argues that liberal democracies and decentralised economic structures were conducive to growth in North America and England in the 19th century, developmental state theorists such as Amsden (1989) and Wade (1990) argue that centralised authoritarian regimes in Korea and Taiwan enhanced the prospects of technology acquisition and the coordination of investments in the context of late development.

The incentives of an institution can be growth-enhancing if the institution is politically legitimate and does not incur high political instability or even war. Khan (1995) provides a useful critique of the idea that institutions are simply incentive structures. The comparison of the experience of industrial policy in the 1960's between Korea and Pakistan is illustrative of the point that endogenising politics is necessary to explain the outcomes of similar institutions. The main point of the article is that the Pakistani state in the 1960's confronted a set of political demands that made very selective and exclusionary subsidisation of industry unfeasible. The political settlements underlying a similar strategy in Korea were more compatible with such a strategy.

The difference between the NIE and a political economy analysis of institutional performance can be seen in Table 1, where the latter gives central importance to political settlements. Since institutions assign distributional advantages, it is important to identify who benefits from a particular rights structure and who is able to block potentially growth-enhancing changes. Khan (1995) argues that the ability of powerful groups to block changes should be considered as 'transition costs' (Khan, 1995). One challenge for political economy analysis is to examine why transition costs are higher in some countries. An understanding of the nature of political settlements and the political coalitions underlying state power are crucial in this regard.

Table 1: Explaining Institutional Performance	
New Institutional Economics	Political Economy Analysis
Differences in institutional performance across countries	Differences in institutional performance across countries
↓	↓
Attributed to differences in institutional structure across countries	Identification of different political settlements
↓	↓
Theories of transaction costs associated with particular institutions	Theories relating political settlements to net social benefits of particular institutions

Source: Khan, 1995: 78.

The relevance of political economy analyses of the political settlement for modern debates on governance is that institutional reform is not simply a technical issue, but one that needs to make conflict and politics a central part of the debate on reform (see Knight, 1992 for a modern treatment of the distributive struggle as a primary force in institutional change).

3. Political Settlements and their Influence on Tax Capacity

Political settlements determine patterns of resource mobilisation that lie at the heart of economic development. Among various means of resource mobilisation (forced savings, inflation gains, manipulation of terms of trade, etc.), tax is the most closely related to questions of state formation and capability. Douglass North, for instance, *defines* the state in terms of taxation powers:

“... an organization with a comparative advantage in violence, extending over a geographic area whose boundaries are determined by its power to tax constituents” (North 1981: 21).

Long before that Edmund Burke remarked: "Revenue is the chief preoccupation of the state. Nay more it is the state."⁸ Tax also provides one of the principal lenses in measuring state capacity and analysing power and political settlements in a society. As Schumpeter notes, “the fiscal history of a people is above all an essential part of its general history” (quoted in Levi, 1988: 6).

A comparison between the experiences of Guatemala and Costa Rica demonstrates how the shape of political settlements influences state performance in taxation.⁹ In the 1950s and 1960s, both countries shared a number of similar characteristics; they were similar in terms of regional location, size, position in the world economy, levels of economic development, colonial history, and both relied heavily on coffee exports for long periods. Both countries had long-standing powerful elites from colonial times until the 1950s. In the case of Guatemala landed elites wielded the greatest power, while in Costa Rica, financial and merchant elites were traditionally stronger. In both cases, these elites had a long record of resisting moves towards democratisation.

In the post-1948 period, the Costa Rican polity achieved a successful consolidation of democracy and has been characterised by political stability and relatively rapid economic growth. In addition, both tax collection as a percentage of GDP has risen to over 20 percent of GDP and income tax collection has risen to four percent of GDP, both from very low levels in the 1960s. The tax take in Costa Rica was the highest in Central America by 2005. *The political, economic and fiscal trajectory of Guatemala in the same period, however, was very different.* In particular, rates of economic growth were much slower, a transition to democracy was absent as the country maintained a military authoritarian regime through the latter half of the twentieth century, and violent political conflict was pervasive with more than

⁸ Quoted in O'Brien (2001: 25).

⁹ This comparison is based on Yashar (1997).

100,000 people (largely poor rural workers) killed by a repressive military government in the 1970s and 1980's.

What appears to be central to the different trajectories of the two countries was the formation of political parties in Costa Rica that transformed the parameters of the political settlement underpinning the state. The Partido Social Democrática (PSD) gained electoral supremacy and political power through a concerted effort *to gain political control of the countryside, which severely weakened the landlord elite*. As the governing party of a revolutionary junta, the PSD further weakened much of the oligarchic elite in the country by nationalising the banking system and dismantling the national army, which had traditionally been an important ally of the economic elites. At the same time they did not rule alone but a minority party, the Partido Unión Nacional (PDN), participated and was committed to democratic transition.

The challenge of the two parties to oligarchic rule opened a 'window of opportunity' for political and economic reform. This challenge, underpinned by mobilising poor rural farmers and the urban middle class, divided urban and rural elites seeking to establish different party affiliations in an attempt to hold on to power. The PSD took advantage of the division within elites to usurp control over state resources. With their electoral power secured in the countryside, the PSD based its legitimacy on introducing significant redistributive reforms that included land reform and the construction of an inclusive welfare state, which would deliver substantial social benefits to both the rural and urban poor, though the urban middle classes benefited substantially as well. To finance the growing welfare state, substantial increases in the tax take and in income taxes were implemented and have continued to this day, where the degree of progressive taxes and the provision of social welfare far outpace Costa Rica's Central American neighbours.

In Guatemala, in the 1940s and 1950s, the military regime faced popular revolts in which democracy and social reforms were demanded. However, unlike in Costa Rica, this did not lead to a division of elites or a transition to democracy, but rather to a coup within the military and a long-term ban on unions and political parties. No party equivalent to the PSD in Costa Rica emerged in Guatemala capable of dividing and defeating oligarchic power. This was first because the economic elite was less diversified in Guatemala, where large landowners (with a greater share of the land than in Guatemala) dominated and financial and merchant groups were weaker. The landed elite did not develop political parties, which might have led them to develop a wider social base that could offset the power of the military. The military itself appropriated some large estates establishing a link with the landowners, who continued a long tradition of labour coercion that was supported by the military. As is well known in works on democracy, military-landlord alliances do not bode well for the prospects of democracy (Moore, 1966; Rueschemeyer et al. 1992). As in Costa Rica, the state did penetrate the countryside effectively, but in Guatemala this rural penetration was achieved through coercive means and was meant to protect the coercive labour practices of landowners. Such brutal repression largely caused grievances

and resulted in organised rural insurgencies and large-scale civil war in the 1970s and 1980s.

The resultant tax base of the state remained very low. One of the main reasons for this was that the wealthiest groups in the economy, the landowners, were part of a political settlement that was not interested in social welfare provision but in maintaining a status quo of privileges. Because the military became large landowners themselves, the prospects of taxing (let alone progressively) the main economic actors were much reduced.

The main lessons:

1) The nature of the political settlement is central to understanding not only political regime trajectories but also the prospects of welfare and tax reforms.

2) A political settlement based on a landowner-military alliance is unlikely to generate tax reforms. In Costa Rica, it was no accident that the government achieved higher rates of total tax collection and income tax collection than in Guatemala. This was because landowners were not the main support base of the government.

3) Regime changes and transitions present 'windows of opportunity' to institute fiscal and welfare reforms. These transitions are likely to involve a transformation of the basis of the political settlement, allowing cross-class political alliance-building. Organised popular sectors are thus able to exact democratic changes in exchange for their political support. Different factions of the elite are likely to divide in the face of organised political challenges.

4) The organisational expression of a political settlement is crucial to outcomes. The extent to which political parties can penetrate the countryside is central to the prospect of pro-poor, welfare and tax reforms. Land reforms can often facilitate increased state capacity to develop land taxes. There are parallels with East Asian countries such as Japan and South Korea, where land reform was central to consolidating the political control of the countryside and to the development of land taxation.

The political settlement underpinning the state is crucial to trajectories of state performance. Developing the capacity of the state to increase taxation is centrally determined by the balance of power, or political settlement, on which the state rests. This is sharply illustrated in other cases as well. The development of a strong fiscal capacity in South Africa was directly related to the nature of the political settlement, which was based on a racist cross-class alliance, which depended on a strong state to maintain white privilege. Upper class whites were willing to pay taxes to the state and a racially defined project allowed lower income whites to demand progressive taxation by drawing on the shared identity of a cross-class white project (Lieberman, 2003).

4. Political Settlements and State Resilience: the role of elite bargains

Political science has long been concerned with the problem of what types of political arrangements, or in our terms political settlements, generate basic political order and stability. This issue concerned Plato, Machiavelli, Hobbes and others. More recent examinations of the issue have argued that, at low levels of development, the general nature of political settlements that are likely to generate political order are far from inclusionary.

North et al. (2007) argue that models of state-building make two assumptions that lead to misunderstanding with respect to how and why polities form. The first is that the state is modelled as a single actor. Insights from the discussion of political settlements make clear that the state rather is founded on a historically determined balance of power between contending interests. The second mistake is the assumption that the state has a monopoly on violence. Well known examples include Olson's (1993) stationary bandit model, and North (1981) and Levi's (1988) revenue-maximising monarch, as well as standard theories of rent-seeking (Buchanan, Tollison and Tullock 1980). Following the insights of Thomas Hobbes, North et al (2007) argue that a more realistic place to begin is to assume that the potential for violence is prevalent throughout society rather than being concentrated. That is, it is necessary to *explain* rather than *assume* that the state has a monopoly on violence. The establishment of political order and peace in the model requires the creation of incentives for groups to compete for resources through non-violent mechanisms – that is, to reach a political settlement.

The principal solution through history to the classic Hobbesian problem of endemic violence is the creation of what North et al (2007) call *limited access orders* (as opposed to the much rarer, open access orders, which characterise advanced market economies). The limited access order creates *limits on the access to valuable political and economic functions as a way to generate rents*. The dominant coalition within a political settlement creates opportunities and order by limiting the access to valuable resources (land, labour, and capital) or access and control of valuable activities (such as contract enforcement, property rights enforcement, trade, worship, and education) to elite groups. When powerful individuals and groups become privileged insiders and thus possess rents relative to those individuals and groups excluded (and since violence threatens or reduces those rents), the existence of rents makes it in the interest of the 'privileged insiders' to cooperate with the coalition in power rather than to fight. In effect, limited access orders create a credible commitment among elites that they will not fight each other. This is the basis for a stable 'elite bargain'.

The shape of the elite bargain on which a political settlement rests is central to understanding differential trajectories of state resilience and development. This is not adequately addressed in the North et al (2007) model. One of the most important propositions that emerges from analytical country narratives in the Crisis States Research Centre (CSRC) suggests that the character and

shape of political organisation has been decisive in determining whether a state moves towards resilience or fragility, or indeed, takes measures to foster the capacity to promote development

The CSP research proceeds from the proposition that states emerge as coalitions of 'elites'. Elites are defined as: a) those in possession of valued assets in agriculture, manufacturing, services (main capitalists); b) those who wield substantial power of adjudication over the distribution and allocation of property rights (traditional chiefs, landlords, regional political leaders); c) those who possess authority to bargain on behalf of rural communities or organised religious communities (traditional leaders, religious leaders); d) those who lead political party organisations.

The 'elite bargain' that underpins the state and is embodied in forms of political organisation is essentially about the allocation of rents. This can take the form of protecting existing landowners or tribal authorities' rights over land, protecting existing capitalists or creating emerging capitalist groups (with trade protection, access to finance, etc.), providing privileged pay and employment to unions (which accommodates their demands and therefore increases the authority of trade union leaders), or creating a managerial public enterprise group (to accommodate political insiders or well connected business leaders).

This approach seeks to understand what makes an elite bargain that underpins a political settlement durable and adaptable to challenges over time, allowing the state to establish and maintain control over coercive power, administrative authority and popular allegiance (e.g., state resilience). First, the research suggests, a bargain that is *inclusive* of the major contending elites and protects their shared economic interests has the best chance to endure over time – a point illustrated by Wood (2000) in her study of El Salvador and South Africa, and by Acemoglu et al (2003) in explaining state resilience and developmental capacities in Botswana. When a political organisation that controls the state excludes major elite interests or de-links political rule from major economic relations with existing elites (as in Uganda under Obote or Amin, illustrated by Golooba-Mutebi (2008), or in Ghana as illustrated by Acemoglu et al) this creates the conditions for fragility and even state collapse. When the political organisation is inclusive, since powerful elites have a share in the distribution of rights and entitlements, they are far less likely to challenge the authority of the state by exiting the coalition and mounting a violent challenge based on the activation of ethnic or regional boundaries. If a section of the elite becomes dissatisfied, the costs of exit from the coalition are high.

Second, the organisational underpinning of the executive authority of the state is central to understanding state resilience. A political organisation is required that ensures that the executive authority maintains an 'encompassing' interest in providing patronage and protecting property rights in such a way as to prevent breakaway and exit tendencies among powerful elites. This, we suggest, can be achieved through a variety of forms of political organisation within a political settlement: a dominant political party, a pact among two main

parties¹⁰, an *institutionalised* alliance of major clans in a country (Putzel, 1999) and no doubt other organisational forms. What is crucial is whether the political organisation that controls the state ensures that the executive, on the one hand, has the authority to act decisively (on allocative decisions or the wielding of coercive power), but on the other, that the executive authority plays by the rules around which the elite bargain has been structured and does not turn to predation or the exclusion of important members of the bargain, which would threaten the stability of the political settlement. It is also likely that the development of national political organisations will coincide with the development of cross-ethnic coalitions, which in turn will help prevent the development of horizontal inequalities that can contribute to political violence.

On the other hand, to ensure that the executive plays by the rules of the elite bargain requires that the political organisation allows for the role of at least one 'third party' enforcer. In the language of George Tsebelis (2002), the political organisation must include veto points that can limit the actions undertaken by the executive authority, which might undermine the elite bargain. In a single dominant political party, this might be the role of the rank and file membership whose loyalty is required for the party to be able to wield its power effectively. The role of third party enforcer, however, might be played by a pivotal interest group. This can be thought of as a group with corporatist links to the state but one that has some capacity to finance its existence without recourse to the state (that is, it is not dependent entirely on state patronage directly). The trade union movement may have played this role in Zambia (Di John, forthcoming (a)) and the cooperative movement in Tanzania (Putzel and Lindemann, forthcoming). In other forms of political organisation this role may be played by a rising bourgeoisie.

Of course, there are other dimensions of the central role played by the political organisation of elite bargains within political settlements in determining trajectories of resilience and fragility (or development). These include the ideological role of the political organisation in control of the state, both in fostering national identity and in broadcasting the state's presence throughout the territory. This may be decisive in terms of developing a state capacity to ensure control of coercive power and administrative authority. There are, as well, important agency factors that intervene that depend largely on the qualities of individual leaders that wield executive authority. It would be hard to imagine an explanation of the trajectory followed in Tanzania without

¹⁰ Political pacts are a set of formal and informal agreements between contending political actors to diffuse potentially disruptive contestation; they establish a basis for restrained and peaceful political competition between major elite camps. Such pacts generally involve power-sharing arrangements in key ministries regardless of who wins elections as well as consensus-building around basic economic policies. Such pacts have been central to facilitating transition to and consolidation of democracy in several countries such as Venezuela and Colombia in the late 1950s, Spain in the 1970s, and South Africa in 1990s. On the role of 'political pacts', a particular organisational form of a political settlement, as engineered bargains among contending elites that avert see Karl (1986) and Di John (forthcoming). On the historical role political pacts have played in transitions to democracy in different contexts, see O'Donnell, Schmitter and Whitehead (1986) and Higley and Gunther (1991). On the role of political pacts in the successful introduction of fiscal reforms (see Di John, 2009: 109-111).

reference to the particular qualities of Julius Nyerere. Understanding the elite bargain that lies at the heart of any political settlement provides a window for assessing state fragility and resilience as well as possibilities for reform and change.

5. Conclusion

The emerging insight that every state is based on an historically specific political settlement provides a route into understanding why very similar sets of formal institutions, like democratic rules or rules governing macroeconomic management or trade liberalisation, or industrial policy, can have extremely divergent outcomes. This is the most important contribution of historical political economy to debates about state-building and where it provides analytical power beyond new institutional economics. The implications of this for the world of development policy are extensive.

Incorporating an analysis of political settlements can take the very positive work done by DFID and others on understanding the 'drivers of change' in developing countries a step further (Leftwich, 2007). This lens allows an analysis of the contending interests that exist within any state, which constrain and facilitate institutional and developmental change. It provides a framework to analyse how the state is linked to society and what lies behind the formal representation of politics in a state.

The political settlement and the elite bargains from which it emerges are central to patterns of state fragility and resilience. The role of political organisation within the political settlement is crucial to both the stability of the settlement and the direction in which it evolves over time. The elite bargains that may lead to the establishment of what might be considered a resilient political settlement may also act as a barrier to progressive developmental change.

Undertaking an anatomy of political settlements suggests that state-building is far from a set of technical formulas, but is a highly political process (Putzel et al, 2009). Creating capacity within a state to consolidate and expand taxation is fundamentally determined by the shape of the political settlement underlying the state. This is true as well for the development of service delivery or any other function of the state.

To undertake development assistance programmes without understanding the political settlement on which a state rests can lead to unintended consequences of all sorts. Not only does the political settlement set the constraints for what can and cannot be accomplished with foreign assistance, but foreign assistance itself can have an impact on the political settlement. This analytical framework provides a window for donors to grasp the politics of a place in order to design more effective interventions.

Appendix 1: Botswana's Political Settlement

Since the 1960s, Botswana has achieved one of the fastest growth rates among less developed countries and has also maintained political stability in the process. Elite bargains underpinning the reigning political settlement have been central to this outcome.

In the period 1925-2000, mineral revenues from diamonds have comprised between 55 and 75 percent of government revenues.¹¹ The main puzzle then is to explain why the reliance on 'unearned income' has coincided with effective governance, political stability, and rapid economic growth, despite having one of the more unequal income distributions in the world.

Central to Botswana's success has been the construction of institutions which have protected private property rights and have provided the incentives for economic and political elites to construct a legitimate central state. The Botswana Democratic Party (BDP) has dominated politics in the post-colonial period. While the BDP has won every election in the post-colonial period, the emergence of different factions within the BDP and from opposition forces has provided the impetus for the BDP to take measures to become more legitimate in the eyes of the electorate. At the heart of BDP legitimacy is its inclusive patronage structures which accommodates urban elites and middle-classes and the main rural elites – chiefs and cattle herders.

How have the particular features of the polity in Botswana contributed to the development of institutions of private property?

After independence, cattle owners were the most important economic interest group and they were politically influential. Indeed, there were close alliances between cattle owners and the dominant political party, the BDP. An often heard comment in the country is that "*Botswana's government was largely a government of cattlemen*". A substantial amount of infrastructure investment favoured cattle ranching regions. Moreover, the fact that the elite was invested in the main export sector explains why the marketing board (the BMC) gave ranchers a good deal and also why the exchange rate was not generally overvalued, which contrasts with many African countries.¹² The political elite were thus enriched by the development policies adopted from 1966.

In addition, political elites faced constraints. The underlying structure of institutions seems to have been important in restricting the range of options, (particularly distortionary policies), available to political leadership. Political accountability was also enhanced by internal competition within the BDP,

¹¹ This section draws on the work of Acemoglu, Johnson, and Robinson (2003) and Holm (2000).

¹² In countries such as Tanzania and Zambia, governing coalitions in the 1970s and 1980s had very little political support base among the most productive farming sectors and, as a result, set up agricultural marketing boards which severely reduced production incentives (see Bates, 1981, 1995).

which was achieved in several ways. First, the policy of organising contests in primary elections throughout the country resulted in significant rotation of elected officials. Second, the BDP permitted a high degree of press freedom which resulted in substantial amounts of criticism of policies and politicians. Third, two important factions within the BDP emerged which enhanced both accountability and political competition. On the one hand, a faction allied with older party cadres supported more statist policies and supported giving civil servants in the government a great deal of power over resource allocation. On the other hand, a faction that comprised groups in support of policies that support, first and foremost, local community projects provided a counterweight within the BDP. Finally, the BDP allowed opposition parties to compete for and (when successful in elections) take control of local councils, which increasingly occurred in urban areas. All of these factors led to institutionalised checks on both the government and the one-party dominated polity. This helped reduce the degree of anti-developmental corruption that can occur when mineral abundance and centralised state-led policies predominate.

Third, the arrival of diamonds occurred *after* the country had developed broad-based political parties, and efficient economic institutions to protect property rights helped avoid destabilising rent-seeking struggles. Due to the generally broad and inclusive coalition of the BDP, diamond rents were widely distributed in the form of infrastructure and social service delivery, which reduced the incentives of elites 'to rock the boat' by forming large-scale challenges to the state authority.

Finally, presidential decisions have been crucial to maintaining political stability. Sereste Khama's decision to transfer the property rights over subsoil diamonds away from his own tribe, the Bangwato, to the government, probably avoided greater conflict among tribes over the control of wealth from diamond revenues. As well, his decision to reduce the political power of tribal chiefs with respect to land allocation just after independence, is also likely to have reduced tribal cleavages and conflicts.

Lessons from the Botswana case:

- 1) Broad-based elite inclusion within a political settlement is central for managing mineral rents effectively.
- 2) The construction of a legitimate, national political party as the organisational expression of the political settlement was central to both: (i) increasing the bargaining power of the government to maximise the tax benefits of mineral abundance; and (ii) organising spending and patronage in ways that promoted political stability and economic growth.
- 3) The promotion of internal political party competition can result in effective checks on government policies even in a political settlement where one party dominates the state.

4) Marketing boards are likely to function more effectively when agricultural interests are included in the political settlement and are the main support base of a democratically elected government in a mineral-abundant economy.

5) While the political settlement in Botswana was inclusive of most economic elites, it was still exclusionary toward many groups and classes. Income distribution is among the most unequal in the world. This underscores that the extent of inclusion in the state patronage system can vary substantially across groups and classes within a polity.

Appendix 2: Political Settlements Underlying Growth and Political Stability: the case of Malaysia

Malaysia, a mineral-abundant economy in the 1970s and 1980s, has achieved one of the fastest growth rates in the world since 1970 and has maintained political stability. In order to understand how this was achieved, it is necessary to examine the underlying political settlement in the state and the role played by political strategy promoted by a dominant political party. In 1969, serious outbreaks of violence occurred between Malays (who are the largest ethnic group but also generally the poorest) and Chinese (a large minority group who were generally wealthier and who controlled most of the big businesses).

The ability of the state to handle this threat of violence depended on the political capacity to organise a redistributive fiscal policy. In the first instance, this required political organisation. While there has been electoral competition, Malaysia is essentially a one-party state. Nevertheless, it is also a polity characterised by significant degrees of clientelist and populist pressure to redistribute income and assets away from the dominant economic groups (comprised mainly of ethnic Chinese), toward the more economically marginalised but majority ethnic Malay population.

The political consolidation and restructuring which took place after the riots established the United Malays National Organisation (UMNO), the Malay party in the ruling Barisan national coalition, as the dominant political organisation within Malaysia's political settlement. The effect of this was to consolidate potentially competing Malay clientelist groups into a unified structure, and, at the same time, it gave the state leaders dominance over Chinese business owners. Let us look briefly at the historical origin of this settlement.

Malaysia gained independence from the British in 1957. Independence was achieved in a relatively non-violent way through a negotiation with the elite-dominated UMNO. Under Tunku Abdul Rahman, the UMNO constructed the National Alliance with the Malay Chinese Association (which was the main source of Alliance campaign financing) and the Malaysian Indian Congress. UMNO won an overwhelming majority in parliamentary election in pre-independence elections. At the time, domestic business was almost entirely in the hand of the Chinese (who were well organised politically and professionally), and the Malays dominated the political elite. UMNO was able to channel and mobilise the large Malay peasantry to support the regime, rather than move into radical opposition.

In Malaysia, a centralised pattern of resource flows emerged in response to middle class demands, which proved to be compatible with rapid growth, and structural transformation of the economy. Paradoxically, the well known ethnic divide in Malaysia between its minority Chinese-Malaysian capitalists and the majority Malay population allowed this centralised redistribution strategy to emerge (Khan 2000, 98-101). The political isolation of the Chinese capitalists

in the Malaysian polity meant that the ruling coalition in the state could effectively 'tax' them for the benefit of emerging intermediate Malay groups.

A consensus emerged among the Malay elite that the economic dominance of the Chinese needed to be reversed. The Chinese make up one third of the population and thus are not negligible in the electoral political system. Nevertheless, the political legitimacy of UMNO was largely based on effectively taxing Chinese businesses while, at the same time, providing them with opportunities to continue investing in the domestic economy, thus creating job opportunities for working class Malays. While the first Prime Minister, Tunku Abdul Rahman, was a strong advocate of parliamentary democracy, the 'ethnic question' in Malaysia meant that ethnicity took primacy over the democratic principle of universal suffrage. As a result, regime legitimacy depended more on effective 'affirmative action' programmes and asset redistribution toward Malays than in instituting democratic procedures and electoral rivalry.

It is also important to highlight why upper income groups, comprised mainly of Chinese, were unable to capture the state and resist personal income taxation as has been the case in many developing countries. The reason largely has to do with contingent historical factors. The integration of Singapore, Sarawak and Sabah in 1963 led to a threat to both Malay dominance and UMNO supremacy within the then nascent democracy. The threat to Malay political supremacy, once Singapore was incorporated into Malaysia, ignited a sense of collective resentment among Malays (Putzel 1995, 246). The tensions that ethnic politics generated led to the forced expulsion of Singapore in 1965.

There were several important political economy consequences of the legacy of the threat to Malay supremacy. First, the main capitalists (ethnic Chinese) in the country lost the political power to legitimately buy off politicians in return for monopoly rents. Maintaining privileged positions for Chinese capitalists would have undermined the New Economic Policy (described below), the cornerstone of UMNO's legitimacy. Second, increases in collective resentment and distrust among the Malays for the Chinese made it more difficult for Chinese capitalists to form clientelist arrangements with intermediate classes of Malays and the political factions representing them. Third, distrust and resentment of the Chinese among the politically dominant Malays brought the issue of income and asset distribution to the fore of the political agenda (Malaysia has among the most unequal distribution of income in South East Asia and an income distribution similar to Venezuela). Chinese privilege was associated with this inequality. Due to the above factors, it was politically much more difficult for wealthy groups (in this case, ethnic Chinese) to capture the UMNO, which was the dominant coalition underlying the state.

In any case, collectively, the resources from mineral rents and taxes were used to create transfers to Malays in many forms: including government-funded education programmes, employment in public enterprises, subsidised loans from the banking system, and preferential access to business opportunities. The growth in the state in the period 1970-1985 is indicative of the massive increases in patronage. Not only that, the massive privatisation

programme of the mid-1980s and early 1990s was also used as a means to transfer resources to a series of Malay political constituents (Gomez and Jomo, 1997: 75-165). This programme of 'affirmative action' proved central to the maintenance of political stability.

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