

Political Settlements and the Analysis of Institutions: An Introduction

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Abstract: The political settlements framework argues that the distribution of organizational power is important for understanding the economic and political effects of institutions and policies. Institutions and policies describe rules that in turn determine resource allocation, and these can affect different types of organizations in very different ways. Organizations can be expected to support, resist or distort particular institutions or policies depending on their interests and capabilities. The distribution of organizational power can therefore determine the institutions and policies that are likely to persist as well as the ones most likely to be developmental in that context. This directs our attention to the importance of accurately identifying the relative power and capabilities of relevant organizations that describe a particular political settlement and how these may be changing over time. The articles in *African Affairs* that have used the political settlements framework demonstrate its usefulness. In this overview we examine the motivations behind the development of the framework and some of the challenges of applying it in the context of dynamic interactions between institutions and organizations. We also discuss the most appropriate definition of a political settlement, the questions the framework is most suited to answer and the challenges ahead for developing the framework and its applications.

The political settlements framework emerged to address two important puzzles facing the analysis of institutions. First, policies and institutions that worked well in some contexts appeared to achieve much poorer results in others. In particular, attempts to introduce some of the rule of law and property rights institutions that were effective in advanced capitalist countries typically achieved much poorer results in developing countries. Moreover, the institutions that worked in some successful developing countries appeared to achieve much poorer results in others. Thus, industrial policy institutions providing support to export-oriented firms were very successful in South Korea in the 1960s but much less so in Pakistan. Secondly, quite different policies and institutions appeared to be effective in solving similar problems in different contexts. For instance, the public provision of education worked better in some contexts, education delivered by NGOs in others. These observations challenged some of the initial advances in institutional analysis coming from the New Institutional Economics. They suggested that to understand the emergence and relative effectiveness of

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institutions, we need to go beyond the institutions themselves and look at the social context in which the institutions were located.

The political settlements framework addresses these questions by arguing that the way institutions work in practice depends on the responses of the organizations operating under these institutions. The relative power and capabilities of organizations are therefore important determinants of how institutions work. The distribution of organizational power is defined as the political settlement.¹ This distribution of power across organizations is typically relatively stable and reproduced over time, even though incremental and sometimes disruptive changes in the distribution of power can take place.

Political settlements have later been defined in a variety of ways to analyse a range of issues. Some of these extensions have been useful, others less so, but overall the progress has been very fruitful. I will, however, point out a number of limitations of other ways of thinking about political settlements. A number of excellent contributions in *African Affairs* have used variants of the original political settlements framework to analyse African development issues.² Variants of this framework have also been used elsewhere to analyse development issues in sub-Saharan Africa and other regions.³ In their insightful Research Note in *African Affairs* reviewing the application of the political settlements framework, Prithish Behuria, Lars Buur and Hazel Gray summarize the most important features of the original framework and its application in a number of articles.⁴ As their article provides an excellent summary of the most important and distinctive features of the framework, I will not repeat what they say. I take a step back to look at the motivation behind the development of the framework to help locate the importance of some of the differences in usage and applications. I will also look at some

¹ Mushtaq Husain Khan, 'State failure in weak states: A critique of new institutionalist explanations', in John Harriss, Janet Hunter, and Colin M. Lewis (eds), *The new institutional economics and third world development* (Routledge, London, 1995), pp. 71-86; Mushtaq Husain Khan, 'Rent-seeking as process', in Mushtaq H. Khan and K.S. Jomo (eds), *Rents, rent-seeking and economic development: Theory and evidence in Asia* (Cambridge University Press, Cambridge, 2000), pp. 70-144; Mushtaq Husain Khan, *Political settlements and the governance of growth-enhancing institutions*, <<http://eprints.soas.ac.uk/9968>>, Research Paper Series on Governance for Growth (SOAS, University of London, London, 2010); Mushtaq Husain Khan, 'The political economy of inclusive growth', in Luiz de Mello and Mark A. Dutz (eds), *Promoting inclusive growth: Challenges and policies* (OECD Publishing, Paris, 2012), pp. 15-54.

² In particular, Prithish Behuria, Lars Buur, and Hazel Gray, 'Studying political settlements in Africa', *African Affairs* 116, 464 (2017), pp. 508-25; Sylvia Croese, 'State-led housing delivery as an instrument of developmental patrimonialism: The case of post-war Angola', *ibid.*, 462 (2016), pp. 80-100; Sam Hickey and Angelo Izama, 'The politics of governing oil in Uganda: Going against the grain?', *ibid.*, 463 pp. 163-85; Abdul-Gafaru Abdulai and Sam Hickey, 'The politics of development under competitive clientelism: Insights from Ghana's education sector', *ibid.* 115, 458 pp. 44-72; Sonia Languille, 'The scramble for textbooks in Tanzania', *ibid.* (2015), pp. 73-96 and Hazel Gray, 'The political economy of grand corruption in Tanzania', *ibid.* 114, 456 pp. 382-403.

³ Recent applications include Lindsay Whitfield, Ole Therkildsen, Lars Buur, and Anne Mette Kjær, *The politics of African industrial policy: A comparative perspective* (Cambridge University Press, Cambridge, 2015) and articles in the special issue on Political Settlements in the *Journal of International Development*, 29, 5 (2017).

⁴ Behuria et al., 'Studying political settlements in Africa'.

of the dynamic aspects of the political settlements framework that are sometimes insufficiently stressed in applied work.

Institutions, organizations and outcomes

Institutions are defined in the New Institutional Economics as rules that emerge to solve particular ‘transaction’ problems. Transactions can broadly describe any social interaction, and rules emerge to govern these interactions, usually with the aim of achieving better results. This is why we have rules for regulating traffic flows to enable faster and safer journeys, rules for organizing firms to clarify who does what, rules for making political decisions about taxing and spending, or rules for organizing the many transactions involved in making long-term investments. However, it soon became clear that the solution to any specific transaction problem depended not only on the specific technical problems and the characteristics of the transacting parties, but also on the broader social context in which the transaction was embedded. The latter determined, amongst other things, the probability that particular rules would be adhered to or enforced. However, the social context is complex, and there were soon many debates on the ways in which the social context mattered, and the most important characteristics of the social context that needed to be captured in an analytical frame to enable institutional analysis to be more useful. This was clearly not just an analytical question but also one of how to interpret complex historical evidence.⁵

The institutional literature began to provide a variety of answers to the growing evidence about the confusing effects of institutions. In particular, the literature began to look seriously at how cultures, norms and enforcement capabilities of governance agencies affected the choice and effectiveness of particular institutions.⁶ The political settlements framework emerged as a critique of approaches that ignored the conflictual aspects of institutions and the conflictual nature of the social transformations that development entailed. It used historical evidence to argue that the distribution of power across organizations affected by particular institutions was usually the most important determinant of the path of institutional change, *and* the effectiveness of particular institutions.⁷ Organizations are groups of individuals who work together in structured ways and are subject to the rules of interaction set by institutions in their transactions with other individuals or organizations. Organizations have internal rules that define

⁵ Mushtaq Husain Khan, 'Governance and growth: History, ideology and methods of proof', in Akbar Noman, Kwesi Botchwey, Howard Stein, and Joseph Stiglitz (eds), *Good growth and governance for Africa: Rethinking development strategies* (Oxford University Press, Oxford, 2012), pp. 51-79.

⁶ Francis Fukuyama, *Trust: The social virtues and the creation of prosperity* (Free Press, New York, 1996); Avner Greif, *Institutions and the path to the modern economy* (Cambridge University Press, Cambridge, 2006); Douglass C. North, *Institutions, institutional change and economic performance* (Cambridge University Press, Cambridge, 1990).

⁷ Khan, 'State failure in weak states: A critique of new institutionalist explanations'; Khan, 'Rent-seeking as process'; Mushtaq Husain Khan, 'State failure in developing countries and strategies of institutional reform', in Bertil Tungodden, Nicholas Stern, and Ivar Kolstad (eds), *Toward pro-poor policies: Aid institutions and globalization* (Oxford University Press and World Bank, Oxford, 2004), pp. 165-95; Khan, *Political settlements and the governance of growth-enhancing institutions*

their internal interactions, so there are institutions within organizations. The state is a set of organizations that operates under rules that are more or less effective in different contexts, and governance agencies like the police or courts are also organizations.

Significant institutional changes are typically not preceded by cultural or normative changes in a society, or autonomous changes in the enforcement capabilities of governance agencies. Rather these changes are typically driven by changes in the distribution of power across relevant organizations, as a result of new political mobilizations, new technologies and economic opportunities, or external shocks. Ideologies, leaderships and external conditions can all play an important role in these mobilizations, but the sustainability of the institutions that emerge depends on whether the changes in the distribution of power required for their effective operation had already come about, or could be brought about as a result of ongoing mobilizations. The determinants of the fluidity or rigidity of organizational power therefore plays a critical role in the political settlements analysis.

Institutions like property rights, which define rules for making decisions about how particular assets can be used, can reduce the transaction costs of coordinating productive activities, in the same way as defining traffic rules can make driving easier. The problem of achieving an adherence to or enforcement of rules is that rules have differential effects on the costs and benefits of different people and organizations affected by the rules. Those who become owners of property rights are from then on at a permanent advantage compared to those who do not, and even the selection of a traffic rule will benefit owners and producers of cars that have their steering wheels on the appropriate side. We describe this by saying that institutions create rents, where rents are defined as incremental changes in incomes created by particular institutions. Policies can be defined as rules that are generally easier to change than institutions, but like institutions, they have similar dual effects. They have an effect on economic, social or political outcomes, but they also change the distribution of benefits in society. As a result of this dual effect of institutions and policies, any analysis of their expected economic and political outcomes cannot be taken for granted without looking at the responses of the organizations affected by the changes in the allocation of rents. Organizations can be *expected* to respond by seeking to change the allocation of rents, and the outcome will depend on a number of factors, *including* the relative organizational and bargaining power of the competing organizations. Institutions that threaten the rents of powerful organizations will be strongly contested and may be reversed, modified or distorted in different ways.

Political settlements

A political settlement (in our definition) is a description of the distribution of power across organizations that are relevant for analysing a specific institutional or policy problem.⁸ The distribution of power describes the likelihood of particular organizations

⁸ Khan, 'The political economy of inclusive growth'; Khan, 'State failure in weak states: A critique of new institutionalist explanations'; Khan, *Political settlements and the governance of growth-enhancing institutions*.

‘holding out’ in contests seeking to influence institutional outcomes.⁹ Powerful organizations with greater holding power can outlast competitors in contests, because they can either deploy more resources to influence governments or other organizations, or inflict greater costs on them, or hold out for longer because they can absorb more pain till others give in. Powerful organizations are therefore more likely to win, and other organizations are more likely to exit or compromise. Thus, the holding power of organizations is not just based on economic capabilities, or on whether they include ‘elites’ (something that we discuss later) but primarily on their organizational capabilities, the capacity of their leadership to mobilize and enthuse, and their skill in identifying and rewarding the right people through formal or informal networks. The only way to start understanding the distribution of organizational power in a society is to look at its history and see how organizations have mobilized, won and lost in the past. This assessment is an art, and it requires a deep understanding of the history, sociology and ideological and identity cleavages in a country, and how they have overlapped with and been used to mobilize around resource issues.

A distribution of organizational power is a political settlement if it reproduces itself over time. This implies a balance between the expectations of different organizations based on their assessment of their relative power and what they are getting through the political and economic process, which in turn depends on the institutions regulating political and economic interactions. Organizations are always mobilizing to change rules, reflecting ongoing changes in their relative power and their activities can further change their relative power. Organizations therefore exercise agency, but what their agency can achieve is limited by the degree of flexibility in the structure of the political settlement. Ongoing incremental changes driven by organizations are very possible and describe the normal evolution of a political settlement. However, occasionally, there may be disruptive changes if some organizations are seriously unhappy with what they are getting. This can lead to the use of organizational power in non-incremental ways, which can range from radical changes in institutions and policies after important events like elections or street demonstrations or even violent conflicts. The characteristics of a political settlement can therefore change as a result of sudden non-incremental changes in institutions and the associated distribution of benefits, but also as a result of long periods of incremental changes. The characteristics of a political settlement can be deemed to have changed when changes in institutions and rent allocations result in significant changes in economic or political outcomes. Thus, changes in political settlements should be associated with changes in specific economic indicators associated with institutions, like rates of investment, rates of technical progress, and so on, or in levels of political stability or of ‘normal’ levels of violence in that society.

The political settlements framework suggests that a social system *tends* towards an ‘equilibrium’ between the distributions of benefits attributed to particular institutions, and the distribution of power across the affected organizations. In advanced capitalist countries, this tendency towards equilibrium usually means that *formal* rules will adapt so that benefits are more closely aligned with the distribution of power across organizations. Think of the evolution of tax laws in many advanced capitalist countries in recent decades as the distribution of power between employers and trade unions have

⁹ Jack Knight, *Institutions and social conflict* (Cambridge University Press, Cambridge, 1992).

changed. Formal rules are rules enforced by legitimate governance agencies like courts, the police and so on. There are many ways in which informality has been defined, but for our purposes we define an informal rule as any rule that is not formal. In particular, this includes rules that are enforced by informal organizations (like mafias) or even by official agencies like the police, if the latter are operating in illegitimate ways. Informal organizations are organizations whose internal rules are informal. In developing countries where many powerful organizations are informally organized, for instance based on patron-client networks, the tendency towards equilibrium may not always involve the adaptation of formal rules but could also include informal violations of formal rules to capture benefits informally. This aspect of informality is particularly important in the political settlements framework.

The tendency towards an equilibrium does not presume that institutions and the distribution of benefits across organizations are ever actually in equilibrium, or even that the distribution of power across organizations is static. Indeed, institutional evolution happens precisely because societies are never in 'equilibrium'. It is the dynamics of this evolution that we are interested in, and the idea of a tendency towards an equilibrium is helpful provided we do not misread this as a movement towards a static or determinate equilibrium. That would imply a reductionist framework that assumes that societies never changed, or agency did not matter, whereas in fact the inspiration behind the political settlements framework is precisely the opposite: to better understand dramatic processes of social transformation in developing countries. Autonomous changes in organizational power, driven by the agency of leaderships, social activists and entrepreneurs are continuously driving the creation of new institutions, while these changes in institutions and policies trigger new mobilizations by affected organizations that can reverse, modify or more deeply embed these changes. This two-way relationship is not determinate or mechanical and the challenge for policy-relevant analysis is to identify the most effective ways in which policy can nudge the evolution of an evolving social system in positive ways, by better understanding these underlying dynamics.

The existence of a political settlement also does *not* imply that there is no violence in a society, or that the economy is working well. Indeed, the aim of the framework is to classify countries in terms of the characteristics of their political settlements, and societies differ quite significantly in terms of the degree of internal violence and economic performance. All that is required for the existence of a political settlement is that the system is able to reproduce, which by definition means that the levels of economic performance or political violence are sustainable in that system. Thus, a distribution of power can be stable even with quite a lot of violence going on as long as formal and informal institutions are allowing powerful organizations to get access to enough resources to enable them to continue with their strategies. In terms of this framework, for instance, a country like Afghanistan may have an identifiable political settlement described by a relatively stable distribution of power across government and rebel organizations despite significant ongoing violence. However, this political settlement is vulnerable to significant disruptions that could substantially change the political settlement if the distribution of power suddenly changes. It is during these periods of disruptive change, when levels of violence may be unusually high, that an identifiable political settlement disappears.

The role of different types of disruptions to political settlements is important to understand. Organizational power changes over time, and organizations that were strong in the past need not continue to be strong in the next conflict. Moreover, we know from game theory that the participants in contests and conflicts are themselves unsure of their real holding power and that is why contests and conflicts happen.¹⁰ If the protagonists had a clear idea of who was going to win in the end, the conflict would not happen. However, most of the time, even when different types of conflicts are happening, the distribution of power across organizations can be objectively assessed, even if the organizations themselves are clearly trying to change this distribution of power. The assessment of holding power is therefore both important as it is difficult, both for external analysts and the protagonists themselves, and it is particularly dangerous to base this assessment on any simple metrics. A plausible assessment has to be based on using the best available historical evidence of organizations and their past mobilization activities in that country, and tested against contrary opinions coming from knowledgeable analysts and practitioners who may have different assessments. An acceptable assessment should be aware of alternative views and be able to explain why that particular assessment was better.

Fortunately, we do not need a map of the relative power of *all* organizations to carry out a particular analysis. The relevant organizations could be limited to a village or municipality, or they could be national organizations, and in some cases they could include global organizations. The specific problems that were initially addressed by the political settlements framework, like the differential performance of industrial policy across countries facing similar international conditions, could be adequately analysed by looking at differences in the relative power of organizations *within* these countries. For other institutional questions, where conflicts between national and supra-national organizations may be important, both international institutions and organizations can be easily incorporated within the framework.

The emergence of institutions

The political settlements framework seeks to provide answers to two related questions. What are the institutions that are likely to emerge in different contexts, and how effective will particular institutions be for achieving specific economic or political objectives? The framework says something about both, but from the policy perspective, the second is often the more important question. We consider answers to the first question in this section and the second question in the following one.

The answers to both are more complex than may appear at first sight. The political settlements framework is *not* saying that the emergence of every policy or institution reflects the balance of power in a country. Particular changes in policies or institutions are the outcome of the agency of governments or other organizations, and are therefore not predictable and certainly do not mechanically reflect the distribution of power in a society. Governments and organizations exercising agency represent particular constituencies, are influenced by their own ideologies, or international pressures and

¹⁰ Ibid.

other contingent factors. Sometimes they make huge mistakes in assessing the reaction to their activities and end up worse off. A government does not typically represent the full balance of interests of all of the powerful organizations in a society. A variety of policies and institutions can therefore emerge at different times. The much more important *dynamic* question is whether the institutions and policies that emerge in this way will survive and be sustainable, and how they will be implemented, given the distribution of power in that society.

The political settlements framework provides a way of evaluating the sustainability of the institutions and policies that emerge, but it does not of course predict the precise institutions and policies that actually emerge. Moreover, the evaluation of sustainability has important differences with other approaches, including those that use the distribution of power to explain the emergence of different types of institutions. Secondly, the political settlements framework also provides answers to the question of relative institutional performance. This is related to its analysis of the role of informal institutions, rule violations and corruption and constitutes the most important contribution of the framework to policy analysis.

The distribution of power is clearly important for explaining which institutions emerge and survive. Powerful organizations are likely to block institutions and policies that are against their interest, or overturn them later, regardless of their social desirability. This obvious point has been made by many researchers including, recently, Daron Acemoglu and James Robinson.¹¹ However, Acemoglu and Robinson's more detailed argument is based on a misleading analysis that leads them to conclude that inclusive political institutions will, *in general*, lead to better, more inclusive, economic institutions. It is based on an implicit argument about why some organizations are more powerful than others, but this argument is not generally true. Their assumption is that when political institutions are not sufficiently inclusive (that is, they do not provide sufficient democratic rights to excluded organizations to mobilize and access power) a few organizations can monopolize power and set up damaging institutions and policies like monopolies that benefit themselves but impoverish the rest of society. The implication is that if political institutions became more inclusive, the interests hurt by damaging institutions would be able to effectively organize to block or overturn these institutions. Socially desirable 'inclusive' economic institutions would then emerge.

The critical assumption is that broad-based productive interests are potentially powerful but are only prevented from exercising their power by political rules that exclude them. The real problem may be much deeper than the absence of particular political institutions. In many developing country contexts, organizations that really want economic institutions that create a level playing field are either non-existent or are very weak for a variety of independent reasons: there may be very few competitive firms that would benefit from a competitive market, many of the most powerful existing firms may not yet be sufficiently productive to really want a level playing field that deprives them of access to rents, and the relatively poor who are constrained by the

¹¹ Daron Acemoglu and James A. Robinson, 'Political losers as a barrier to economic development', *American Economic Review Papers and Proceedings* 90, 2 (2000), pp. 126-30; Daron Acemoglu and James A. Robinson, *Why nations fail: The origins of power, prosperity and poverty* (Profile Books, London, 2012).

privileges of the few may face serious collective action problems because there may be too many of them, they may be too poor, or they may have too many diverse interests. In these contexts, making political institutions more inclusive by enhancing formal rights to mobilize or rights of representation in political decision-making does not necessarily mean that productive interests become more powerful. Instead, it could further enhance the political influence of already powerful unproductive organizations.

The sources of organizational power are therefore critical and are not at all discussed by Acemoglu and Robinson. Organizational power is not always latent, and waiting to be expressed if political institutions would only allow this. Nor is organizational power related to the economic resources that groups can mobilize. Holding power is based on the capacity to mobilize and organize, using a variety of resources, of which the capabilities of mobilizing money is just one. The capacity of some social groups to mobilize others using identity politics or ideologies, and the possibilities of using identity, ethnic or other cleavages to organize patronage politics and large 'inclusive' clientelist parties are examples of specific capabilities that determine the types of organizations and groups that are most likely to benefit from more inclusive political institutions.¹² The characteristics of both economic and political organizations are therefore critical for understanding how particular institutions will operate.¹³ All of this constitutes the historical 'data' about the configuration of organizational power that we need to have before we can assess the implications of changing institutions, including political institutions, in particular directions.

In many developing country contexts, the most powerful organizations often have interests that constrain broad-based growth. Political parties may want to capture resources for their clients in ways that are socially damaging. Productive firms may be few in number and have low competitiveness, and they may prefer to ally with clientelist politicians to augment their incomes. In these contexts, institutions that facilitate greater political inclusion may strengthen these types of organizations by making their organizational and influencing activity cheaper and easier. They may also enable additional clientelist organizations to emerge, seeking to capture rents for yet more constituencies. As a result, reforms making political institutions more inclusive may not have a positive effect on economic development in every context. This is not an argument for or against democracy or political inclusion, but an argument for looking carefully at the structure and capabilities of organizations in a country to assess the impact of specific changes in political institutions, even if democracy is justified on other grounds.¹⁴

¹² For an analysis of how intermediate class politics has evolved in Bangladesh and how this has affected the characteristics of its political settlement, see Mushtaq Husain Khan, 'Class, clientelism and communal politics in Bangladesh', in K.N. Panikkar, Terence J. Byres, and Utsa Patnaik (eds), *The making of history: Essays presented to Irfan Habib* (Tulika, New Delhi, 2000), pp. 572-606.

¹³ Figures 17 and 18 in Khan, *Political settlements and the governance of growth-enhancing institutions*.

¹⁴ Adam Przeworski, Michael E. Alvarez, Jose Antonio Cheibub, and Fernando Limongi, *Democracy and development: Political institutions and well-being in the world, 1950-1990* (Cambridge University Press, Cambridge, 2000); Mushtaq Husain Khan, 'Markets, states and democracy: Patron-client networks and the case for democracy in developing countries', *Democratization* 12, 5 (2005), pp. 705-25.

The analysis of political settlements should also make us wary of arguments in the opposite direction. Some developmental state theorists have come close to saying that versions of authoritarianism may be helpful or even necessary at early stages of development, on the grounds that 'state autonomy' can make it much easier to introduce policies and institutions that are in the social interest.¹⁵ This too is based on a partial set of observations and can be equally misleading. Like democracy, authoritarianism describes institutions governing the rights of political organizations to mobilize and participate in political power. The consequences of authoritarian political institutions for development depend, in exactly the same way, on the distribution of organizational power and mobilization capabilities. Authoritarianism can potentially deliver reasonable outcomes if these institutions are not excessively disrupted and challenged by powerful organizations. Authoritarianism can then create incentives for leaders to take a long view, and they can end up being developmental in their own interest. However if excluded organizations are powerful and can informally challenge and distort resource allocations, authoritarianism may achieve poor results. If these networks can block or distort the leadership's resource allocations, they can damage the achievement of long-term goals and create incentives for the leadership to join in the damaging rent capture as its own second-best strategy. In addition, if an authoritarian regime faces internal organizational challenges that are growing in intensity, it is likely to become more and more repressive, and any developmental characteristics are likely to be rapidly lost with increasing repression. In these cases too, the political settlement is increasingly vulnerable. Low-level violence can grow in intensity and the institutional structure can collapse with an outbreak of significant violence, often at great social cost.¹⁶ In all these cases, institutional and policy outcomes can be much worse than in the imperfect democratic alternatives.

The political settlements framework allows us to assess these scenarios, particularly in contexts where authoritarian regimes claim that while they may not have inclusive political institutions, they are nevertheless developmental, and political inclusion will follow.¹⁷ Development first and political inclusion later was indeed the trajectory of a few successful developmental states (like South Korea), but many other countries failed to sustain growth or political stability with authoritarianism, even after a few years of successful development. These countries became increasingly repressive and their developmental institutional structures ultimately collapsed (like Pakistan in the 1960s or the Philippines under Marcos). The political settlements that allowed successful developmental authoritarianism in some countries were actually quite special, and a

¹⁵ For instance, Adrian Leftwich, 'Bringing politics back in: Towards a model of the developmental state', *Journal of Development Studies* 31, 3 (1995), pp. 400-27.

¹⁶ As it did in Pakistan in the 1960s, despite its political and economic institutions being very similar to those in South Korea, Mushtaq Husain Khan, *The political economy of industrial policy in Pakistan 1947-1971*, <<http://eprints.soas.ac.uk/9867/>>, Department of Economics Working Paper No. 98 (SOAS University of London, London, 1999) <<http://eprints.soas.ac.uk/9867/>>.

¹⁷ See for instance, Mushtaq Husain Khan, *Anti-corruption in Bangladesh: A political settlements analysis*, <<https://ace.soas.ac.uk/working-paper-3/>>, ACE Anti-Corruption Evidence Working Paper No. 3 (SOAS University of London, London, 2017) <<https://ace.soas.ac.uk/working-paper-3/>>, which makes the argument that the construction of an authoritarian developmental state is not feasible in contemporary Bangladesh.

general application of the model to other countries can be just as misguided as the attempt to drive inclusive growth by pushing for inclusive political institutions in every context. Both types of simplistic responses may have unintended consequences that are the reverse of what their advocates may have wanted. The proposed institutional changes can result in sudden increases in conflicts, greater repression and worse development outcomes. The political settlements framework provides a way of analysing the structural and organizational factors that can account for these differences. Political institutions are simply rules for determining who exercises power and how. But the outcomes of the implementation of these rules cannot be determined without a specification of the economic and political organizations in the country, their capabilities and relative power, and how they are likely to respond to these rules.

The effectiveness of institutions

The second question is possibly even more important. How do organizations influence the *implementation* of specific institutions? Institutions and policies may not be blocked or overturned, but their implementation and effectiveness may be seriously affected by the activities of powerful organizations. This turns out to be of very great significance, particularly in developing countries. In advanced countries, powerful organizations that are adversely affected by particular institutions and policies can be expected to pressure governments to revisit these rules. In developing countries, however, their response is likely to include distortions and corruption that can informally modify the implementation of particular institutions or policies in line with their own interests. The most important challenge for policy-makers and analysts in developing countries is to assess how specific institutions and policies can be designed to achieve particular objectives given the high likelihood of such distortions. The political settlements framework shows that this design challenge is an important one.

The issue of institutional distortion and corruption is one of the most important contributions of the political settlements framework. At a broad level of generality, the framework can explain the significant differences in the institutional characteristics of advanced and developing countries. The former are significantly more ‘rule-following’ than the latter. The enforcement of ‘good governance’ has proved to be hugely difficult in developing countries. Good governance is essentially the enforcement of a rule of law by and within legitimate state agencies like parliaments, the police, courts, anti-corruption agencies, and so on. Advanced countries appear to adhere to a rule of law to a much greater extent despite the fact that many developing countries spent a lot of resources attempting to improve their enforcement of a rule of law. It is important to distinguish between a genuine rule of law, where the enforcers of the rules are also subject to the law, and ‘rule by law’ where a strong state enforces rules on weak social organizations without being subject to rules itself. There are examples of the latter in some developing countries, but a true rule of law only appears to emerge much later.

The political settlements framework provides a compelling answer to this puzzle. Powerful organizations in advanced countries want a rule of law in their own interest because they are typically productive organizations that depend on complex contracting to generate their wealth. These organizations are also rich and powerful enough to pay

for the enforcement of a rule of law and to insist that state organizations should also be subject to the law. The emergence of a large number of dispersed organizations that are productive and powerful appears to be historically necessary for the emergence of a rule of law. In contrast, powerful organizations in developing countries are generally not productive organizations that rely on complex market contracting for their prosperity. As a result, they typically do not want the enforcement of a generalized rule of law. Collusive behaviour provides much higher returns to the powerful in these contexts. When there are a few powerful organizations, they can make trust-based transactions with each other or rely on informal enforcement to carry out their important transactions. Strengthening the capabilities of enforcement agencies is unlikely to make a significant difference to the enforcement of a rule of law in this context. The challenge for developing countries is how to achieve broad-based development using appropriate governance strategies in such contexts till a broad-based distribution of power based on productive capabilities emerges. Only at that point is there effective demand for a rule of law, and the enforcement of good governance becomes feasible.¹⁸

In countries where a generalized rule of law has not yet emerged, powerful organizations are likely to capture rents by distorting the implementation of formal institutions and policies or distorting the implementation of rules they see as contrary to their interests. Indeed, this is often the *only* way in which these organizations can operate because it is usually impossible to devise formal rules to provide targeted benefits to powerful informal organizations. Formal rules have to be transparent and therefore at least appear to be in the public interest. It is therefore hard to direct resources to powerful clientelist organizations using formal rules. There are exceptions. For instance, a history of ethnic or caste deprivation can be used to justify formal transfers to particular groups or organizations whose power is based on patron-client mobilizations, but these are exceptions. The formal system of caste reservations in India is an example. More typically, informal patron-client organizations capture rents for their constituencies using informal mechanisms such as the distortion or evasion of formal rules.

For instance, powerful firms in advanced countries may lobby for rules that give them access to credit on favourable terms to finance their (usually productive) investments. Equivalent firms in developing countries with low productive capabilities but with powerful informal networks may prefer to distort formal rules to get loans they are not entitled to, or to default on their repayments. Of course, violations of formal rules can also happen in advanced countries, but they are less common. This insight can help to explain why we see much greater *informality* in developing countries that takes the form of significant deviations between what formal rules say and what happens in practice, why formal institutions and rules often appear to be *difficult to implement* in these contexts, and why there is so much overt rule-violating behaviour that manifests itself as *corruption*. All these phenomena are related to a distribution of organizational power that works by distorting the implementation of formal rules to bring about a

¹⁸ Khan, *Political settlements and the governance of growth-enhancing institutions*; Mushtaq Husain Khan, 'Governance, economic growth and development since the 1960s', in José Antonio Ocampo, K.S. Jomo, and Rob Vos (eds), *Growth divergences: Explaining differences in economic performance* (Orient Longman, Zed Books and Third World Network, Hyderabad, London and Penang, 2007), pp. 285-323.

distribution of benefits that more closely reflects the interests of powerful organizations that are informal and often with low productive capabilities.

This leads to the vital policy question: in such contexts, which institutions and policies are most likely to promote the achievement of particular social objectives? The political settlement analysis is *not* saying that if institutions can be aligned with the interests of powerful organizations, development will necessarily happen. This is because powerful organizations in any context want to enrich themselves, not society. Developmental outcomes require complex checks and balances to ensure that incentives and compulsions work to generate the broadest possible growth in welfare. Aligning institutions and policies with the powerful is particularly problematic in contexts where powerful organizations have low productive capabilities and are more likely to distort formal rules to capture resources. The difficult policy challenge is to determine the types of policies that would push low productivity organizations towards more productive behaviour in these contexts *given* our understanding of their capabilities and the relative power of the relevant organizations.

An analysis of rents is one way of digging deeper into this process. Institutions and policies that have developmental objectives also create new flows of incomes (rents) and disrupt old ones. One way of tracking why developmental objectives may not be achieved is to look at how the checks and balances set by other organizations work to constrain the organizations that are supposed to deliver with particular institutions. Can they ensure that the organizations getting the rents are the ones that are supposed to get these rents, and can they be made to actually deliver or achieve what they were supposed to? We describe these checks and balances as the 'rent management' system. The distribution of power across the organizations involved in checking and balancing the allocation and use of particular rents can critically affect the outcomes associated with specific institutions.¹⁹

For instance, institutions that provide tax revenues to health providers to achieve public health objectives may fail if health providers or their internal organizations are able to capture these resources without delivering results. Whether they can or cannot do this depends on the objectives and relative power of other organizations affected by these rent-allocating institutions, such as organizations of patients, the state's monitoring agencies in the health sector, competing health providers, and so on. Similarly, institutions or policies can create benefits for some firms through tariffs with the objective of helping them to acquire competitiveness through learning-by-doing. Can they capture these benefits and live an easy life, or are there checks and balances that compel them to use this opportunity to become competitive and allow the state to shift support to other sectors and firms? Once again, the answer will depend on the configuration of power across a number of different types of organizations. Policies can create extra profits for some firms with regulations that restrict market access to regulate quality. Is this just a monopoly for providers who deliver poor services or are regulators able to ensure that the rents that providers get is justified by safer and higher quality services, for instance in taxi rides? Some rents can be subtle, such as the incremental gains and losses for organizations as a result of regulations, for instance those that limit the use of polluting technologies or which require minimum

¹⁹ Khan, 'Rent-seeking as process'.

construction standards. In each case, the social outcome depends on the capabilities and activities of relevant organizations that collectively constitute the rent management system for that institution.

Some policies and institutions create rents for explicitly political purposes, rather than to achieve economic or developmental objectives. Many redistributive transfers, both formal and informal are of this type. While these rents may have economic costs as they can deprive productive organizations of resources or create disincentives for them, there may also be political benefits in maintaining political stability and averting costly conflicts. Not all political rents are therefore necessarily wasteful when these political costs and benefits are factored in. However, even here, rent management matters. Too much may be redistributed, or to the 'wrong' groups, so that the costs are higher than benefits. Transfers to some groups rather than others can also trigger conflicts that can lead to destabilizing the political settlement. The most useful application of the political settlements analysis is to look at these dynamic rent management issues to identify the effectiveness of existing institutions and to identify alternative ways of managing these rents so that better development outcomes can be achieved in that political settlement.

There are likely to be better institutional alternatives in every context because there are potentially many different solutions to particular 'transaction problems'. In some contexts, allocating resources through the public education system can result in the employment of too many unqualified teachers because they belong to politically powerful networks that capture rents through job creation. The political settlement framework can be used to evaluate whether alternative rules for allocating resources for education, for instance through NGOs or other organizations, could work *relatively* better in that context. If tariffs to protect infant industries are failing because firms with powerful networks are capturing these rents without putting in the effort of raising their productivity through learning, the political settlement framework can be used to evaluate whether other forms of delivering support to infant industries may induce higher effort in learning given the current configuration of organizational power. In countries where conventional industrial policy failed to produce good results because powerful firms captured rents without delivering results, other ways of incentivizing learning, for instance by rewarding foreign companies to transfer organizational capabilities to domestic ones, have been hugely successful.²⁰ The political settlements framework can explain these differences in institutional outcomes, and why institutions and policies need to be designed differently to be effective in specific contexts. This type of analysis can clearly have significant implications for effective policy design.

Defining political settlements differently and ways forward

²⁰ Mushtaq Husain Khan, 'Technology policies and learning with imperfect governance', in Joseph Stiglitz and Justin Yifu Lin (eds), *The industrial policy revolution 1. The role of government beyond ideology* (Palgrave, London, 2013), pp. 79-115; Mushtaq Husain Khan, 'Political settlements and the design of technology policy', in Joseph Stiglitz, Justin Yifu Lin, and Ebrahim Patel (eds), *The industrial policy revolution 2. Africa in the twenty-first century* (Palgrave, London, 2013), pp. 243-80.

The political settlements framework discussed above uses a definition that identifies macro-political organizational characteristics of societies that are important for answering the types of questions discussed earlier. However, other definitions of political settlements have emerged and are also widely used. In particular, political settlements have sometimes also been defined as common *understandings* or *agreements* amongst *elites*, about how resources are distributed and power is exercised. This definition was originally presented as being equivalent to the original definition of a political settlement as a *distribution of organizational power*.²¹ But in fact the two definitions are not interchangeable as their analytical underpinnings are quite different. The later definition is based on a common sense interpretation of the term political settlements, understanding it as an agreement of some sort between elites, particularly of a type that emerges at the end of a period of conflict. It has the merit of converting a somewhat complex analytical idea into language that a variety of practitioners can understand. If the understanding or agreement between elites accurately reflects the distribution of organizational power in society, the two definitions can take us to the same place. Unfortunately, there is no reason why that should necessarily be the case.

A further advantage of the elite pact definition is that if we understand a political settlement as a ‘pact’ that brings ‘elites’ together, it is possible to see why such an agreement may result in conflicts ending, and set the stage for policies being formulated that are likely to be implemented. Peace is also plausibly likely to hold if a pact is ‘inclusive’ in the sense that all relevant elites are included. Defined in this way, there is also a similarity between this definition of a political settlement and Acemoglu and Robinson’s analysis of inclusive political institutions. Although the arguments are somewhat different, the claim here is that a more ‘inclusive’ political settlement is more likely to be stable and therefore allow greater development. The elite pact definition has become the definition of choice for researchers trying to analyse transitions from conflict to peace and the sustainability of a social order.²²

Despite their apparent similarity, the two approaches to political settlements are analytically quite different and can potentially give different answers to a range of policy questions. While some political settlements in our sense can indeed be underpinned by a pact or agreement between elites, this is by no means generally the case. What matters in defining a sustainable political economy at the macro level is not an explicit, or even an implicit, agreement or pact between *elites*, but a stable distribution of power across *organizations*. First, the relevant elites in developing countries are a problematic category to try and identify without looking at the organizations they can mobilize. Many individuals or groups who we may describe as elites, like large landlords or educated professionals, may have very little organizational power in many contexts. In contrast, many groups that we may not consider to be ‘elites’, like newly emerging rural or small town political activists, may be able to

²¹ Jonathan Di John and James Putzel, *Political settlements: Issues paper*, <www.gsdrc.org>, (Governance and Social Development Resource Centre GSDRC, University of Birmingham, Birmingham, 2009) <www.gsdrc.org>.

²² See for instance, Christine Bell and Jan Pospisil, 'Navigating inclusion in transitions from conflict: The formalised political *unsettlement*', *Journal of International Development* 29, 5 (2017), pp. 576-93; Alina Rocha Menocal, 'Political settlements and the politics of transformation: Where do 'inclusive institutions' come from?', *ibid.* pp. 559-75.

mobilize huge numbers of supporters through patron-client politics and wield considerable holding power. At local levels, powerful organizations can often be quite unexpected, for instance poor women organized by NGOs can be a locally powerful organization. Focusing on elites rather than formal and informal organizations can therefore be very misleading.

Secondly, even in the special cases where powerful organizations map exactly onto groups of elites, the stability of the social order may not require any explicit or implicit pact or agreement between them. A stable organizational power structure, which defines the political economy in a way that is useful for institutional analysis, is a description of a complex outcome of contestation where powerful organizations accept the rents they receive as the best that is feasible, without disruptive mobilizations that attempt to change the distribution of power. There may be no overt pact or agreement at all. Even in advanced countries, 'elites' belonging to different parties or classes may be involved in intense and apparently no-holds-barred competition, without any implicit pact about how to govern or share rents, and yet the overall distribution of organizational power may be quite stable because no group can change this distribution of power. Conversely, overt pacts and agreements can break down almost instantly, as they so frequently do in war-to-peace transitions, if the mobilization capabilities of the warring organizations change as a result of their organizational activities.

Therefore, how we define a political settlement matters. Even if we are interested only in assessing the sustainability or vulnerability of a social order, a framework that focuses on the distribution of organizational power can allow more precise questions to be asked about the calculations and expectations of competing organizations. This is directly relevant for understanding whether the rent-seeking strategies of organizations are likely to be incremental or disruptive. In contrast, a framework that looks at the inclusiveness of a pact between elites can give misleading answers because it ignores the organizational basis of conflicts and the sources of holding power of the different parties. Too much inclusion of 'elite' organizations that are actually not organizationally powerful can be just as unsustainable as too little inclusion of powerful organizations. The really important questions are about the sources of power in that context and how mobilizations are being organized. This information is vital for assessing whether the current distribution of organizational power is likely to change in incremental or disruptive ways, and the implications for institutions and policies in that context.

However, we are not just interested in identifying the vulnerability or otherwise of a political settlement. We are also interested in an institutional analysis of the sustainability or effectiveness of *particular* institutions and policies. The organizational power framework of political settlements comes into its own here. It provides the data and analytical categories for a rigorous analysis of institutions, rents and their economic and political outcomes. The elite pact framework does not direct us to the information required for analysing the *effectiveness* of particular institutions or policies, or help us assess *alternative* institutions or policies that may work better in that context.

The elite pact definition of a political settlement should therefore be treated as a distinct approach that can provide complementary information, rather than essentially the same analytical framework articulated in a different language. The construction of, and changes in an elite pact may be useful for tracking aspects of organizational

activity, namely the coalition-building activities of elites. This can tangentially have important implications for political settlements defined as reproducible structures of organizational power. But the two are usually not the same thing.

Conclusion

The articles contained in this virtual issue use the organizational power approach to political settlements. They identify how the distribution of power can explain the emergence of different types of policies and institutions that may otherwise be hard to explain. Some use the framework to analyse why the outcomes of particular institutions and policies have been particularly poor. Some have gone into the sources of organizational power and offer interesting insights into how holding power has been constructed in different contexts.

This introduction to the virtual issue is intended to remind us of some of the complex analytical questions that underpin the framework and the exciting challenges of deepening the application of the framework in future work. We need to dig further to get a better understanding of the sources of organizational power in different contexts, how this has been changing and may change further in those contexts, the mobilizations that challenge the overall national political settlement in incremental or disruptive ways in different contexts and the implications for policy. Furthermore, we need more innovative research on the challenging question of how to design institutions and policies to achieve better rent-management results in specific contexts.