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Abstract

What are the underlying drivers of human development? This essay argues that long-term human development, in incomes, social conditions, security and so on, is fundamentally driven by capitalist dynamics and state functioning. The big issue is not state versus market, or growth versus equity, or dynamism versus security. It is the jointly determined functioning of both capitalism and the state. It is in particular a consequence of the extent to which both capitalist and state behaviour is oligarchic, extractive, exploitative and divisive as opposed to being inclusive, innovative, accountable, responsive and effective at mediating distributional conflict. This can be conceptualized, at a point of time, in terms of the nature of the political equilibrium, or, alternatively, the way in which social contracts work. This is a product of the historically shaped interaction between political and economic elites, and between these and various social groups. Specific policy designs of course matter, whether in terms of market-related policy, regulation, designs for social provisioning. But the ways in policy and institutional choices work, and indeed the choices societies make, is intimately linked to the nature and functioning of the underlying social contracts that in turn shape capitalist dynamics and state behaviour.

Keywords: capitalism, growth, poverty, human development.

JEL classification: I00, O10, P10, P16

1 Introduction[1]

What are the underlying, long-term drivers of human development? This essay seeks to provide an interpretation in terms of the nature and dynamics of capitalism and the functioning of the state. It is neither an empirical analysis nor an attempt to systematically review the vast literatures on various aspects of the issues. It rather draws on these literatures to develop an overall argument. The 20-year edition of the Human Development Report, for which this paper was written, would seem to be a good opportunity for such an exercise.

I follow in the tradition of the HDRs in treating human development as a multi-dimensional conception of the possibilities people have for leading a good life.[2] This, essentially opportunity-based, conception, can be imperfectly proxied by observed outcomes of material wealth, educational status and health status, along with other more complex dimensions of well-being, including dignity and participation in social and political life.

So what has to be explained? Take the following stylized facts on the core measurable dimensions of human development:

- Huge inter-national, and inter-personal inequalities in all dimensions of well-being, associated with massive differences in opportunities.
- No inter-country convergence in material dimensions of well-being, but major, growth surges in East Asia and India, that has been a force for convergence for some groups of people in the world.
- Steady, long-term advances for most, but not all, nations and groups in both educational and health status over the past few decades, with apparently significant convergence by some measures (the most important exception relating to the impact of HIV/AIDS on health status in a set of mainly Sub-Saharan African countries)

[1] Thanks to Sam Hickey, Jeni Klugman, Lant Pritchett, Ana Revenga, Francisco Rodríguez and Frances Stewart, for comments and conversations.
[2] This is based on the conceptualizations by Sen, see Sen (1984, 1999).

These have occurred in the context of major economic and political shifts since the first HDR was written in 1990. These include:

- Substantial spread in the reach of broadly capitalist forms of production—albeit in differing varieties—with the collapse of the former Soviet Union, the rise of a form of capitalism in China, and significant reductions in state controls of economic activity in many countries, most notably India.
- Major systemic economic shocks at the global and national level, including in particular the crises in East Asia in 1997-98 (centred in countries associated with the "East Asian Miracle") and the international financial crisis of 2008-09 that started in the core of the global capitalist system in the United States.
- The steady extension of formal, procesual democracy in much of the developing world and the former Soviet Union.
- The spread of local participation in many developing countries, whether via political decentralization (for example in India and much of Latin America) or growing use of participation in service delivery.

The issue to be explored is how these two categories of development are related. This is framed around three questions.

First, what is the role of different forms of capitalism in terms of (i) economic dynamism (ii) effects on inequalities and inclusion, and (iii) short-run volatility and long-run sustainability?

Second, how does the functioning of the state affect human development in terms of (i) the accountability to all citizens of national polities (whether or not this is under formal democratic auspices), (ii) the reach and effectiveness of local participatory processes, and (iii) the extent to which exclusions of stigmatized or exploited groups has changed?

Third, what are the deep drivers of any shifts in the relationship between capitalism, state functioning and social and economic progress?

Here is an outline of the argument.

Capitalism—in its varied forms—is the only institutional mechanism capable of supporting *sustained* economic dynamism, that is necessary, but insufficient, for transformative changes in most dimensions of human development. However, there are large contrasts between different forms of capitalism, with respect to long-run dynamism and effects on inequality and insecurity. This is particularly the case between "oligarchic" forms of capitalism and open, inclusive forms of capitalism. Some forms of oligarchic capitalism—often in concert with significant levels of state engagement—*can* be sources of extended periods of advance, but this is rarely sustained beyond two to three decades, and is often associated with high levels of inequality. With respect to other dimensions of human development, while capitalist advance can lead to growing demand for skills and a healthy workforce, there are also tendencies that lead to conflicts with security and dignity, and heightened inequalities, absent complementary societal and state action. Finally, capitalism is intrinsically weak, again absent countervailing policies, on questions of environmental sustainability, given the time horizon of most firms and the widespread importance of externalities in this area.

The state is the second dominant force affecting the success or failure in the dynamics of human development at the national level, both through its indirect role in shaping the nature of capitalism and its direct role in social provisioning, via finance, actual provision and regulation, in domains that include education, water and sanitation, public health and a range of institutions for the provision for security and the protection of citizens from abuse. State action is powerfully complementary to capitalist dynamics in influencing human development outcomes. But there are also large varieties of state behaviour. Indeed, there is an analogous contrast in performance between relatively oligarchic, extractive states and accountable, inclusive states. While the extent and pattern of political accountability lies behind this contrast, these variations occur under both authoritarian and democratic auspices. However, an accountable and responsive state under authoritarian auspices is much more likely to be contingent on the particular configuration of political forces. Furthermore, despite the theoretical role of government in providing public goods and managing externalities, states are also often weak on environmental sustainability, a consequence of short political and electoral time horizons.

The issue for human development concerns the form of capitalism and the nature of the state. The systemic functioning of both capitalism and the state is often aligned, in terms of the degree to which both economic and state-mediated processes support inclusive, long-term advances in human development. More fundamentally, capitalism and the state form part of an integrated social, economic and political system. There are, of course, specific tradeoffs on the division between state activity and the market, but the big questions are not around state versus market, but over the jointly determined nature of capitalism and the state. The deep drivers of this lie in politics, and in particular the nature of the underlying social contracts between the state, business and various social groups, including, in particular, the relationship between political and economic elites. Another way of putting this is in terms of the extent to which the political equilibrium supports institutional arrangements that foster more inclusive forms of capitalism and a more accountable and inclusive state.

This structuring of institutions interacts with what may be termed *capacities* of both capitalists and the state. Such capacities flow from historically shaped developments, and go way beyond the effects of generalized education. While they are surely endogenous in the long term, at a point of time (in the dynamics of decadal change) these can have substantial influence. Broader societal conditions—from socio-cultural norms to civil society organisations—are of great importance, including in influencing behaviours of business and state actors. But specific civil society action is typically subsidiary in its proximate effects to capitalism and the state. Finally, global influences also matter—notably technical progress related to health, effects of international markets in goods and finance, aid flows, the general influence of ideas and spillovers of conflict. However, these generally influence human development essentially in their interaction with domestic institutional structures.

The essay is an interpretation that is based on various existing literatures: selected references are provided along the way. Here I would particularly highlight the work by Acemoglu, Robinson and co-authors (e.g. 2004, and forthcoming) on the institutional foundations of development, Rajan and Zingales (e.g. 2003) on capitalism, Morck and co-authors (e.g. 2004) on corporate functioning, Lindert (2004) on the history of social provisioning in now-rich countries, Engerman and Sokoloff (e.g. 2001, 2002) on historical comparisons across the Americas, and work in the World Bank (2005) on equity and development.

The remainder of the essay is organized into four sections. The next two sections review respectively the role of capitalism in relation to material advance and other dimensions of human development, and the state in relation to social provisioning. Section four then discusses the question of deep drivers of capitalism and state functioning, focusing on the role of implicit social contracts; this includes a brief account of categories of country experiences and transitions There is some discussion of policy along the way, and a final fifth section draws some implications for approaches to policy of this diagnostic prism, drawing on two examples from quite different domains—the Indian economic liberalisation, and a specific instance of Mexican social policy reform.

2 Capitalism and human development

Capitalism comes in various forms. Let's take as a working definition that capitalism is a form of organizing production that involves extensive private ownership of the means of production, with associated property rights over the fruits of production for firms and of effort for workers. However, the nature of productive organizations can range from peasant farms to informal family enterprises, and from family controlled conglomerates to firms with dispersed ownership via stock exchanges. Often there is state ownership of parts of the system. Capitalism can cover a multitude of sins—from highly competitive markets, to state-private mixes, to oligarchic dominance—with varying degrees of property rights. These differences can have a profound effect on performance. A useful categorization, drawing partially on Baumol et al (2007), is between state capitalism (in which the state plays an active directive role, with selective ownership), oligarchic capitalism (in which major parts of the business sector and associated markets are dominated by family-controlled firms), and forms of capitalism in which the underlying institutions are supportive of entry and exit of activities—Schumpeterian creative destruction—that can involve either large or small, "entrepreneurial" firms. In the following, I also emphasize variations within oligarchic capitalist forms.

There is not a readily available measure of the form of capitalism, or the degree of oligarchy. That is one reason why this is an interpretative essay, rather than an empirical paper. To give some motivation, Table 1 (from Claessens, Djankov and Lang, 2000) shows measures of the extent to which top families in East Asia controlled listed corporate assets in 1996—just before the East Asian crisis. For the top 15 families, this was over 60% in Indonesia, 55% in the Philippines, 38% in Korea and 34% in Hong Kong. For Mexico, the top 15 firms in the stock exchange—all family-controlled—accounted for 40% of total value—and this is a substantial underestimate since it does not account for pyramids.

Table 1. Control of publicly listed capital by top families in East Asia

Country	Average number of firms per family	% of total value of listed corporate assets that families control (1996)				% of GDP (1996)
		Top 1 family	Top 5 families	Top 10 families	Top 15 families	Top 15 families
Hong Kong	2.36	6.5	26.2	32.1	34.4	84.2
Indonesia	4.09	16.6	40.7	57.7	61.7	21.5
Japan	1.04	0.5	1.8	2.4	2.8	2.1
Korea	2.07	11.4	29.7	36.8	38.4	12.9
Malaysia	1.97	7.4	17.3	24.8	28.3	76.2
The Philippines	2.68	17.1	42.8	52.5	55.1	46.7
Singapore	1.26	6.4	19.5	26.6	29.9	48.3
Taiwan	1.17	4.0	14.5	18.4	20.1	17.0
Thailand	1.68	9.4	32.2	46.2	53.3	39.3

Source: Claessens, Djankov and Lang, 2000.

So how does capitalism influence the various dimensions of human development? Here are some hypotheses, with respect first to the average material well-being in a society, and then to other dimensions of well-being, inequalities, insecurity and sustainability.

The long-run transformation of average levels of material well-being is only feasible with a capitalist dynamic.

In historical perspective, capitalism has been extraordinarily successful in some parts of the world: in pushing the world's technological frontier, in supporting modest steady growth over the very long term in now-rich countries, and in the dramatic transformations that have occurred, at an unprecedented historical pace, in the small number of countries that have sustained rapid growth. The latter include in particular Japan, Korea, Thailand and Malaysia and others of the earlier East Asian miracle phase, in phases in Brazil and Mexico, and in ongoing processes in China and India.

All cases of transformative success have involved some mix of indigenous capitalism and participation in global markets. However, none have involved the ideal of free markets and atomistic firms. Most have rather involved a blend of state involvement and oligarchic features of the pattern of ownership of the business sector. This has taken the form of a significant share of state-owned enterprises and state banking in China, and to a lesser extent India. It has involved extensive state engagement with the business sector in Japan and Korea. The typical business ownership structure for the large firm part of the economy has been of family controlled conglomerates, notably in Korea, Thailand, Indonesia, India, Malaysia, Brazil, Mexico etc.—in other words with the structural features of oligarchic capitalism.

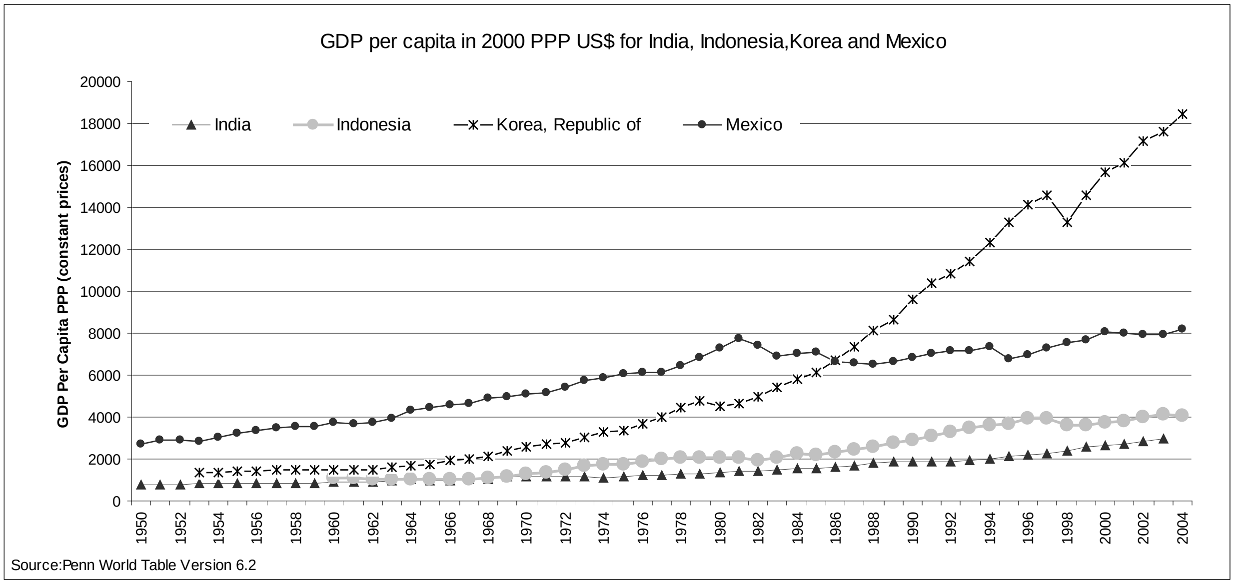
The most important exception to this view is the initial, multi-decade growth of economies in the Soviet Bloc: full state ownership and planning was able to support an extended period of catch-up in average levels of production per head. But this involved very high levels of inefficiency, that both reduced the pace of advance in material living standards and eventually proved unsustainable.

But capitalism has also been less successful, or pernicious, in many areas

Despite the dominance of some form of capitalism throughout the world, the pace and pattern of expansion of average living standards has been immensely varied. There are several types of malaise.

First, a capitalist dynamic can lead to transformative periods of growth that then peter out: Brazil and Mexico are iconic examples. Indonesia in the wake of 1997/98 crisis looks similar. Figure 1 illustrates the contrast between India, Indonesia, Korea and Mexico: it shows that Mexico's past "miraculous" growth took it to average levels of productivity way above where India and Indonesia is now; and that Korea's sustained growth marked an additional, dramatic transformation in production. Moreover, this had big impacts on measures of material poverty: on the international yardstick of US$2 (at purchasing power parity), the proportion of Mexicans living in poverty was 5%, compared with 76% for India in the mid-2000s.

Figure 1. Varied experiences in average living standards: GDP per capita in India, Indonesia, Korea and Mexico between 1950 and 2004



Source: Penn World Table Version 6.2

More generally, growth spurts are quite common; what is rare is sustained rapid growth (Hausmann, Rodrik and Pritchett, 2005). The Commission on Growth and Development (2009), found only 13 economies that have grown at 7 percent or more for 25 years or longer—these include the familiar East Asian cases, plus Botswana, Brazil, Malta and Oman (India hasn't yet crossed this threshold, and Mexico didn't quite make it.) Kharas (2009) used the term the "middle income trap" to characterize economies who managed to get to middle income status, and then suffered a meandering growth path, seemingly failing to effect the further, Korean-style transformation.

Second, a capitalist dynamic has failed to take off in any transformative fashion in many poor countries, especially in Sub-Saharan Africa. There is certainly a mix of small-scale entrepreneurial activity—often in informal, unregulated parts of the economy—and selected large-scale investments by foreign firms, notably in mining sectors. But there has been no sustained take-off. Even a Brazilian or Mexican style problem of growth that then peters out would have a huge impact on the poor countries of Sub-Saharan Africa.

Third, capitalism in its oligarchic form has often distorted both market structures and governmental functioning. This occurs to some degree throughout the world, including in rich countries such as the United States. However, such distortionary influences are particularly pervasive in countries such as Mexico, Russia, the Philippines, and latter phases of Indonesia's high growth period. In Mexico, for example, oligarchic business structures dominate formal production, and are a source of high costs and restricted supply in many sectors (see Levy and Walton, 2009 for a collection of assessments). Telecoms is a telling example: the privatization of the public telephone company under President Salinas led to a temporary monopoly of the privatized entity, owned by groups controlled by Carlos Slim Helú. When formal competition (backed by an independent competition authority) occurred, the company could use its market power, its influence, and a weak legal system to sustain its position of market dominance, leading to high costs, restricted supply, and high profits. This helped Slim on a path to becoming, in early 2010, the world's richest man.

Fourth, failures in information and regulation led to a pattern of innovation and expansion of financial capitalism that created the global financial crisis of 2008/09. This had some features of big-firm influence on regulatory design—analogous to pernicious aspects of oligarchic capitalism.[3] It was also a consequence of a market system that provided incentives for product innovation that obscured the underlying properties of financial products. This, knowingly or unknowingly, contributed to private enrichment but heightened risk, and to excessive innovation of a socially harmful kind. Apart from the high costs of the crisis itself, this structure was also a source of long-run growth problems, given the powerful incentive for allocation of some of the best talent—including scientific minds—into financial product development rather than productive innovations.

Interpretation of varied growth dynamics

How should this varied mix of experience be interpreted? Observed experiences are of course a product not of capitalism alone, but of the interaction between capitalist processes, state action and social functioning. With this caveat, here are some interpretations on the functioning of capitalism:

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[3] See in particular Johnson and Kwak (2010).

- First, a positive capitalist dynamic is extraordinarily difficult with insecure property rights, at least for the capitalists. Large-scale production is typically limited to forms of extraction (from legal mining to blood diamonds). Resolution of security of property rights, is not, however, a question of transplanting legal and regulatory institutions from now-rich countries. Such institutions work within a political and social context. As an example, the Mexican growth occurred because of the essentially informal, politically supportable mechanisms that led to good-enough protection of property rights for domestic large business families (essentially oligarchic businesses with good connections) and, post-NAFTA, for foreign businesses (Haber et al. 2003, 2008). In similar spirit, business aspects of Indonesian rapid growth were based on a self-enforcing arrangement between the Chinese capital and the political, including military, elite around Soeharto (further discussed below). This security of property rights, at least for some groups, has to be consistent with the other side of economic change: that capitalist transformation also requires significant reassignment of property rights, notably for natural resource extraction and land for industrial production. This requires mechanisms to manage this vis-à-vis social groups, mechanisms that may be extractive or equitable.
- Second, oligarchic forms of capitalism can be associated with high levels of investment and growth for extended phases—especially where there is potential for substantial economic rents (for which property rights for the capitalists is one condition) plus some pressures for innovation and change. Thus the Brazilian and Mexican growth miracles. However, oligarchic forms are also associated with economic entrenchment (the consolidation of the economic position of incumbents[4]) and are thus often intrinsically weak on creative destruction; this may explain common successes in periods of import substituting industrialization under protective barriers. They also have a strong tendency to exert influence over, or capture, state behaviour. This can further support extraction of rents from consumers and other producers.
- Third, the nature of state involvement has a formative influence on capitalist dynamics. The state often supports capitalist growth—indeed almost all periods of rapid growth have had some degree of either state ownership or support—but state engagement suffers from analogous problems to oligarchic forms. These are linked: the combination of state

[4] See Morck, Wolfenzon and Yeung (2004) for a discussion of entrenchment.

involvement and oligarchic capitalism can both help *solve* problems of credibility of commitment and of obtaining the information on the "needs" of capitalists, *and* can lead to collusion for rent-extraction that is bad for average growth. A particularly developed form of the first scenario—the state as supporter of and counterweight to capitalist advance—was a feature of some of the East Asian successes, characterized as "embedded autonomy" by Evans (1995).

- Fourth, there is an issue of entrepreneurial and organisational "capacity". This is surely endogenous over the long term. However, a feature of most significant growth episodes has been the action of indigenous capitalists—for example, India's takeoff from the 1980s was, at least initially, based around a set of longstanding business families. Mexico's growth—while stalled in the long term—also was around families with business traditions. Chinese business families were at the centre of much of the East Asian growth take off, from Indonesia to mainland China. Korean business family-run chaebol drove Korean expansion. And so on. In a historical perspective Bayly (2008) emphasizes the interaction between colonial action and local business capabilities as shaping post-independence growth and business dynamics in India and some African countries. This can, of course, be a two-edged sword, since on the other side of strong business "capacity" lie the excesses of oligarchic capitalism. It is sometimes suggested that reliance on foreign capital constitutes an alternative: many countries have indeed made use of foreign investment (Ireland and Singapore are striking examples), but extreme reliance on foreign firms is rare, and there is something important around the domestic capacity.

Acemoglu and Robinson (forthcoming) argue that long-term economic growth is only feasible in the context of "inclusive economic institutions", by which they mean a set of institutional arrangements that support the enforcement of property rights, guarantee law and order, support contract enforcement, allow new businesses and activities to enter and existing activities to be destroyed, and support the functioning of markets for goods, labour and capital. They contrast these with "extractive economic institutions", that are associated with rent creation and extraction. Extractive economic institutions can be aligned with growth in average material standards for a while, but do not support the broad-based, as opposed to selective, protection of property rights, or the processes of creative destruction that are necessary for long term growth. This prism is relevant to the variety of experiences outlined here: oligarchic capitalism is the dominant form in development, but breeds successes and failures; there is something about the interaction with other institutions, and especially with the functioning of the state, that shapes this dynamic. Acemoglu and Robinson further argue that inclusive economic institutions are only consolidated in the context of inclusive political institutions. We return to these questions in Section 4 on interpretation and the role of social contracts.

Capitalism has a mixed record on other dimensions of well-being.

Let's now turn to other aspects of well-being. It is useful to distinguish between different dimensions of well-being (or different functionings in Sen's terminology) and properties of those dimensions across the population, including inequalities (with deprivation of the poorest of particular welfare interest), volatility and sustainability over time. Thus the discussion in the previous section was confined to *average*, or *typical*, levels of *material* well-being. Here I start with a perspective on three clearly distinct dimensions—health status, education status and dignity. Then in the following subsections, I turn to questions of inequality, insecurity and sustainability.

Given the limited space available, the large and varied literatures, and the fact that we actually observe the products of complex interactions between capitalism, state action and society, the following considerations require even more heroic acts of distillation and synthesis than the preceding section. But I think it is worth a try. Here goes.

Capitalism and education. It is useful to assess the influence of capitalism in terms of direct economic effects—capitalist "demands" for skills—and the indirect effects on societal and state functioning, and engagement in provisioning.

With respect to educational attainment, in current phases—including the past few decades—the direct effects of capitalism has been largely in favour of increasing educational attainment. This is for the obvious reason that more educated workers are more productive: modern industrial and service production requires at least basic education for "unskilled" production workers, complemented by a range of higher skills in management, engineering etc. Of equal importance for long-term growth, sustained productivity increase requires steady educational upgrading, as economies shift up the ladder of sophistication, capital-intensity, skill-intensity, and organizational requirements of production, both in terms or product mix and production processes. This is driven both by domestic wage increases as the unskilled labour market tightens, and global interactions, as new economies enter labour-intensive production for traded goods. Both domestic and global influences lead to the skill-biased technical change that has been an important source of widening of wage differences, discussed below. A particular aspect of the upgrading involves the role of high-level skills in innovation, both in adaptation of products and processes to domestic conditions, and in pushing out the frontier by global leaders in economic production.

This positive effect is not universal. Both historically and in the contemporary period, some forms of production have depended primarily on brute force, and employers have had an interest in low-wage, unskilled work—or, as in mining and construction, on-the-job training usually from when young men first enter the workforce. In a particular case, Tendler (2003) found a preference of industrial firms in the North East of Brazil to have unskilled—only primary education—workers, on the grounds that secondary educated workers would have a preference for service sector work and would be more difficult to control. She termed this the “fear of education”. A broader fear of education may occur if economic elites are concerned about the effects of education on political mobilization of the masses—there have been plenty of regimes that have systematically neglected education. Bourguignon and Verdier (2000) formally model the trade-off between the productivity raising effects of education, and the potential costs to elites of loss of income shares and power.

With respect to indirect effects, probably the most important issue concerns interactions with tax-raising by the state, that is necessary to support state provisioning of education. Businesses typically prefer low taxes, and are often effective in lobbying for these.

Finally, private schooling and university education is becoming an important source of delivery of education, and can both alleviate supply constraints and be a source of upward pressure on quality.

Capitalism and health. Effects on health status are more difficult to assess. Firms have a demand for a healthy workforce, but the links between capitalist demands and general health are complex. Much of the improvement in health status in developing countries comes from public health interventions—around water and sanitation, immunization etc—that firms have little direct demand for. Indeed, in some areas of mining and industrial production, the effects on health status of workers and their families can be pernicious, either because effects on worker productivity are low in the short run or because ill-effects are external to the firm (see the review of mining production in India in Centre for Science and the Environment, 2009, for many examples of adverse influences.) Provisioning of insurance for curative health is likely to occur only when it is in a firm's interest to maintain the health of its whole employee pool, or where such pooling and associated insurance can form a part of a preferred remuneration offer (that would be expected to lead to a lower money wage). The US problems in both company-linked insurance, and in the effects of the private insurance part of the health system on costs and exclusion, are a vivid illustration of the problems. These include the role of concentrated lobbies as a block to rational health reform.

On the production side, private firms play a large role in provisioning for curative health in most developing countries. This is an important source of service, but issues of regulation, information, quality and insurance remain pervasive. In addition, private provisioning of water and sanitation has risen in significance since the 1990s: this has not taken off nearly to the extent of private supply in telecoms and utility, but, if well-regulated, can lead to expansion in supply that is good for consumer welfare and health. A study of the Argentine water privatization attributed improvements in infant mortality to expansion of private supply at a municipal level (Galiani, Gertler and Schardgrodsky, 2002)

Capitalism and dignity. Perhaps yet more difficult to generalize is the influence on human, and especially worker, dignity. There is, of course, widespread documentation of historical and contemporary abuse: employers often lack incentives to treat workers with respect, and have asymmetric power. There can also be productivity gains for firms from workplace conditions that confer greater dignity on work. But there is no guarantee that this will be the dominant outcome—that is that firms who support the dignity of their workers will outcompete abusing firms. Where capitalist advance is associated with greater formalization of work this can bring a set of complementary gains for workers, in terms of the quality of the workplace, whether this flows from governmental regulation or worker organization and action.

Capitalism can be associated with rising inequalities, but effects are mixed and contingent.

The intuition of many observers is probably that capitalism is good for dynamism, and so for average levels of well-being, but is inequality-increasing—absent countervailing action by the state—as it intrinsically involves big rewards to the successful, even before you get into questions of influence. There is something important to this intuition, but it is not the whole story by any means.

Let's start by noting some domains and locations capitalism has had significantly inclusive elements. Here are some important examples.

- The expansion of formal work—that is (contingently) associated with greater worker protections on security, health hazards and dignity—though this is typically good for insiders, those who can access formal work, and is not relevant to households dependent on informal work.
- The entry of new large, medium and small firms within countries. This is the converse of entrenched, protected business oligarchy, and, when it occurs, is a source of greater equality of opportunity in the entrepreneurial space, as well as greater economic dynamism, through its effect on creative destruction. As an example, India in its current 25-year period of relatively rapid growth—has witnessed both expansion of a range of long-established business families, often from traditionally business-oriented castes and groups, *and* broader entry of individuals into successful business—including from castes traditionally not associated with business, including amongst Hindus from the so-called "other backward castes" (Damodaran, 2008)
- The entry of developing country multinationals into global markets, including emblematic groups such as LG and Samsung from Korea, Tata from India, América Móvil from Mexico. Now this involves the entry of rich groups and individuals, in terms of capital resources and wealth, but is surely a specific form of global horizontal equity—and one that is often of governmental and societal interest.

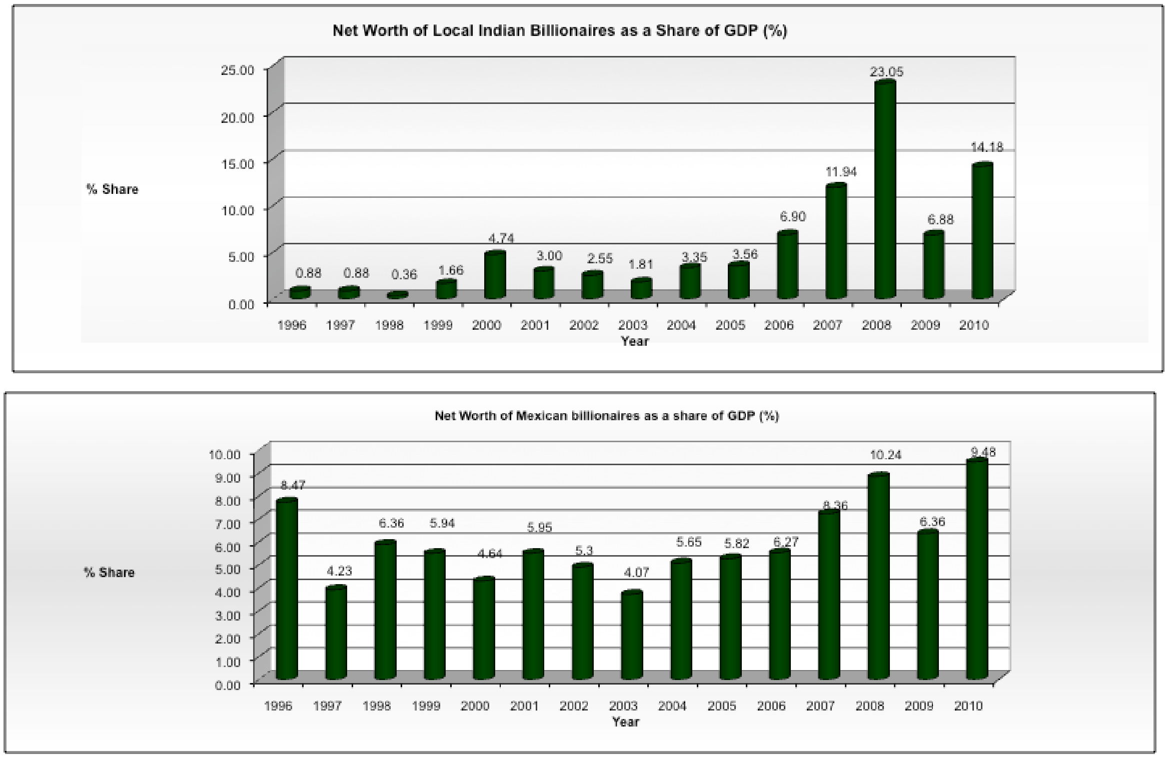
- At the other end of the social scale, capitalistic and market-oriented processes can be a source of the breakdown of traditional, unequal social differences. For example, in India, there has been a gradual breakdown of caste-based work allocations, that historically confined *dalits* (previously known as untouchable groups) to the most menial and often demeaning forms of work. A recent survey involving retrospective interviews find substantial changes in both work allocation and consumption choices amongst *dalit* groups in one of the poorest and supposedly "backward" parts of the India, rural Uttar Pradesh.[5]

On the other hand, capitalism has been associated with substantial pressures for increased inequalities, for example in the following areas.

- Extreme concentrations of wealth, whether in obscene top salaries in the US, or the more typical form of the combination of business wealth and oligarchy that revolves around family firms in developing countries (notably in India, Indonesia, Malaysia, Mexico, Thailand, Russia…indeed almost all middle income countries). The Forbes billionaire list is the tip of the iceberg, though provides one measure, illustrated for India and Mexico in Figure 2.
- Unequal relations of work, and heightened health risks (especially in mining) and in some areas abuse of workers.
- The skill-biased technical change and the growing globalization of wage determination. Skill-biased technical change was a driving force between rising wage differences in Latin America in the 1980s and 1990s, for example, often mediated by the structural shifts mediated by opening to trade and foreign direct investment (see Sánchez-Páramo and Schady, 2003 for an empirical assessment for six major countries)

[5] This work is not yet in the public domain; this result is based on discussion with Devesh Kapur and Lant Pritchett.

Figure 2. The evolution of billionaire wealth in India and Mexico



Source: Forbes.com and World Development Indicators.

However, the *net* effect of capitalism and all other things going on in society is often unclear, with ambiguous or contingent association with inequalities of income and wealth. As has been well documented, the United States, the leading capitalist nation, experienced a long fall in inequalities in the first part of the 20th century followed by a long rise. A major part of the story lies in the interaction between rising demands for skills and rising supply—the race between education and technology (see Goldin and Katz, 2008). But part of the interpretation has also been attributed to shifts in what is supported by the polity, a product of a mix of effective lobbying and prevailing narratives, whether these are consistent with the empirical evidence of not. (Atkinson 2003; Piketty and Saez, 2001 though they don't frame the argument in terms of lobbying pressures.) Some of the iconic cases of rapid, long-term capitalist advance—Japan, Korea, Taiwan—appear to have done so at relatively modest levels of inequality. However, in recent decades many developing countries have experienced rising inequality. This is true of China, almost certainly true of India, as well as for other South Asian countries. In Latin America there have been more increases than falls in inequality (de Ferranti et al 2004), though

Brazil in the 2000s enjoyed a significant decline in its initially very high level of inequality. Data on Sub-Saharan Africa is too weak to support a firm view on an overall trend, though it is noteworthy that the region has some of the highest levels of income inequality in the world.

Some observers go further and argue that capitalism intrinsically causes poverty—see, for example, Harris-White (2005). As a general, long-term phenomenon, this is hard to support. There are particular cases where capital has caused hardship—interactions with mining investment providing many examples—but on average, where capitalism has been successful in the developing world, it has been associated with reduced, not increased poverty. The biggest short-run qualification to this view comes in crises.

Capitalism and insecurity: bad in crises

Capitalism has been associated with dramatic economic crises, with profound adverse effects on well-being. In the past twenty years, there have been crises in countries with a tradition of macroeconomic instability, including Argentina, Mexico and Turkey. But this was also the period of the East Asian crisis, that was shocking because it was at the heart of *the* great development success of the post-war period, in a set of countries that had proved to be pretty resilient to previous economic shocks. And it, of course also involved the sub-prime crisis, that was even more shocking as it started at the heart of the most developed part of the global capitalist system.

Crises have large adverse effects on average well-being. Moreover, the losses are often distributed in an inequitable manner. Crises involve large changes in asset prices, economic recessions and increased spending for some, especially through automatic stabilizers, bailouts and discretionary increases in safety net or compensatory spending. Those who gain—relatively, and sometimes absolutely—are generally those with greatest information and financial agility, groups protected by automatic stabilizers (unemployment insurance in countries, depositors where there is deposit insurance) and those with influence. In financial and currency crises, this can often include insiders to the financial system, at the expense of outsiders. Analysis of Latin American crises found that financial sector insiders often got their money out early and even enjoyed capital gains when domestic asset prices collapses, (as in Argentina), and were often bailed out in financial system rescue packages, sometime including equity holders (as in Mexico, for example) (Halac and Schmukler, 2003, de Ferranti et al 2004). While democratic or other popular pressures typically induce some discretionary spending (including, to varying degrees, in Argentina, Korea, Indonesia and Thailand) these are typically small relative to the size of bailouts. Meanwhile wages generally suffer large declines, and wage shares fall—implying shares of profits rise (Diwan, 2001, 2002). The fiscal bill is financed by future increases in taxes and reduced spending—and since spending is often progressive at the margin, this can also be inequitable (de Ferranti et al, 2004)

Do the periodic crises represent a deep flaw of capitalism? A better way of seeing this is as an intrinsic feature of capitalist processes, especially in the absence of perfect information and markets, where these are insufficiently countervailed by effective policy. Part of this is a question of smarter regulatory and policy design—avoiding premature capital account liberalisation (now, belatedly, even recognized by the IMF), saving commodity booms (as Chile very successfully did when copper prices were high in the recent period) managing carefully the introduction of new financial products (though how to do this is still hotly contested in the United States). But political economy and underlying political and social structures come in here as well. Many countries aspire to contracyclical fiscal policy, but many increase fiscal deficits in the good times—something that the United States under President George W Bush and Venezuela under Hugo Chavez had in common. One of the big debates in the wake of the subprime crisis is whether the political influence of large financial institutions has led to the consolidation of moral hazard in the post-crisis policy and regulatory action of the United States (as Johnson and Kwak, 2010, argue).

Two other points are relevant to the relationship between capitalism and insecurity.

First, the net effect of capitalism and state action has led to a dualistic design of risk management in most developing countries, in which formal mechanisms for managing health, unemployment, accident and other forms of worker and household insecurity are linked to formal contracts in large firms. This was not inevitable: it rather formed part of the Bismarckian heritage of social security design, that was based around employment. It has high costs: in creating disincentives for formality, in creating politically salient groups with an interest in their continuance, and in weak provisioning for outsiders. This is ill-designed capitalism.

Second, in poor countries the most common, and devastating, shocks are not associated with macroeconomic crises, but rather with the weather, catastrophic health problems and natural disasters. These have little or nothing to with capitalism.

Capitalism and sustainability: intrinsically inadequate

To some degree a mixed story also applies to environmental sustainability: in the sense that predominantly capitalist societies did a lot better than old-style socialist countries in the Soviet bloc, that had a typically awful record on the environment. However, this was probably more to do with weak democratic pressures, poor information, and the slow technological upgrading of communist industries to newer, cleaner production techniques.

Beyond this unhappy comparison, there are important areas where the incentives at the heart of capitalism fly in the face of either local or global sustainability. This is seen in local water and air pollution from industries and mining, in environmental destruction in many mining activities or in the resistance to facing up to climate change (including amongst European industries that managed to get the quotas in the European cap and trade system allocated free rather than auctioned.) In some areas—such as effects on social living conditions of mining—there are also adverse social effects, associated with displacement and ill-health. These are classic cases of external effects, often interacting with time horizons of firms that are shorter than appropriate for the evaluation of societal well-being. And, as in most areas, they can interact with political and social structures, especially where the adverse effects are concentrated in groups with weak political influence or social status, and state officials and politicians are bribable.

Interpretation and policy

Let's step back and have a first assessment of what this account means for policy and institutional design. The proximate issues relate to the form of capitalism, the incentives capitalists face, and interactions with complementary policies and institutions, that both influence the behaviour of capitalists and the preparedness and protection of workers, consumers and affected households. The big issue is how capitalism and markets become embedded in social and political structures. This was a central concern of Polanyi (1944) that is still highly relevant today: reviewing an earlier phase of capitalism up to the Second World War he argued that capitalist structures induced a dual movement—on the one hand of concentration and social costs driven by the internal dynamic of capitalist production processes; on the other a countervailing political demand for social provisioning, security and the regulation of capitalist excess. The latter can lead to over-reach as (arguably) occurred with some aspects of Eurosclerosis, or the Fabian bent of much Indian industrial and social policy in the initial post-independence period.

Subsequent experience, including of developing countries, supports the view of swings and tensions between reliance on "self-regulating" features of capitalism and assertive government action (Stewart, 2010). It is certainly true that capitalism has good and bad faces—it can be a source of expansion of wealth and of social costs. But the contrast between some forms of oligarchic and inclusive capitalism are *also* salient to the variation in aggregate growth rates in material conditions. In other words the choice is not necessarily between dynamic aggregate growth, with social costs along the way, and more modest growth with better social conditions. All too often the worst types of oligarchic capitalism—often embedded in the state—are bad for average growth, even if they do well at extraction of short-run rents for the influential. On the other hand, more inclusive forms of capitalism are not only more dynamic, but can be consistent with greater equity and security.

So what are the implications for policy? Let's start with proximate policy choices—neglecting political economy for a while. Here the issue is not simply one of regulating capitalism: experience clearly shows that excessive regulation can lead to an overbearing state, or can be captured and influenced by alliances between business and political elites, or with protected worker groups. This is where the old-style pro-market critics are right. But right now the system has sicknesses that need to be fixed—for the sake of broad-based human development *including* aggregate growth. It is useful to divide this into policies that shape the institutions of capitalism itself, and complementary measures.

(a) policies affecting the institutions of capitalism

What kind of policies constitute "open economic institutions", in Acemoglu and Robinson's term, that are necessary for innovation and creative destruction? Here's a sketch of a list:

- Institutions that allow entry of new business activities, and protect property rights equally for new entrants and incumbents; competition policy, financial inclusion, minority shareholder rights and underlying legal and institutional designs. These are at the core argument of *Saving capitalism from the capitalists*, by Rajan and Zingales (2003), in an argument that goes back to Adam Smith.[6]
- Evening *up* the "business environment" for small and medium firms, that are typically subject to harassment and abuse from police and bureaucrats, often linked to inappropriate urban and regulatory designs against informal activity.
- Forms of regulation of mining and utilities that tackle market failures, including social and environment externalities and network effects, in ways that also reduce risks of either capture or excessive hold up.
- More speculatively, in terms of technical design and political economy, fostering an environment for the development of indigenous businesses and local innovation, potentially with policies on foreign direct investment that provide either strong incentives for domestic linkages, or temporary protection.

(b) complementary policies to increase human development gains from capitalism

A second category of policies belongs primarily to the direct functioning of the state, but is pertinent here because of the tight complementarity with capitalist dynamics—think of these as efficient designs for the Polanyi dual movement. Here's a second list:

- Society-wide checks and balances in the functioning of the legal system and democratic institutions of the legislature and executive—all of which are essential to the functioning of the institutions of capitalism.

[6] Khemani (2007) provides a view from the World Bank on the gains, and practical ingredients of competition policy.

- Vigorous action on provisioning of education, to equip all to participate, including both basic education for all, and meritocratic access to higher education (that raises a host of institutional design and political questions).
- Provisioning of forms of protection of workers from insecurity and abuse that don't tax the capitalist dynamic, and in particular are not linked to the labour contract, but *do* rely on taxing business incomes and the wealth and consumption of all.

How to shift from "bad" to "good" capitalism?

In all this the deeper question concerns the circumstances in which societies shift to adopt institutions and processes that support more inclusive, more stable and more sustainable forms of capitalism, since the above policy lists are largely endogenous. This is *the* big question, and is taken up after discussion of the functioning of the state. However, it is still of value to consider the proximate policy "choices" just surveyed, and how they relate to the current functioning of alternative forms of capitalism. This is not least because existing narratives often obscure what is really happening, whether this is embedded in a "pro-market/capitalist" or "statist" discourse.

3 The state, social provisioning and human development

In this part I turn to the behaviour of the state, with a particular focus on direct action affecting human development. At one level this enters traditional domains of state activity for social provisioning: the state is often *the* major actor in a wide set of activities associated with human development, especially in the narrower characterization of human development as being connected with education, health and other aspects of the management of individual and household risks. After all, the big innovation of the original Human Development Index was to add measures of educational and health status, to offset what was then perceived as an excessive preoccupation with aggregate income growth. And a frequent, explicit or implicit, perspective in the human development tradition has been around the desirability of greater public action in areas such as schooling, health services, water and sanitation and so on.

However, the underlying focus here is different. Consistent with the approach to capitalism, the issues of interest concern the drivers of the behaviour of the state—viewing specific actions, say in providing schooling services, regulating utilities, provisioning for risks, as endogenous products of how the state functions in response to political and social pressures. The question is not so much whether the state delivers on the latest list of development desirables—conditional cash transfers, village education committees, employment guarantee programmes etc. Such designs *do* matter, as do specific learnings from experience across and within countries. But these are second order to the incentives, political base, work cultures, rules, capacities and checks and balances of different parts of the state. In a simplified account, a state can be oligarchic or inclusive, and this will often parallel the condition of capitalism.

With this context, of particular interest are the following trends of the past 20 years or so:

- The spread of formal, procesual democracy, with the rise (or return) of democracy in most of Latin America, its extension in Sub-Saharan Africa, radical shifts in many states previously in the Soviet Bloc, and transitions from authoritarian rule in parts of East Asia (including Korea in the 1980s, Indonesia in the late 1990s), alongside the sustained consolidation of democracy of India.
- The rise of local, participatory democratic processes in different forms, including in the form of decentralization to local governmental units (in many parts of Latin America, in the *panchayati raj* system of rural India) and the emergence of a powerful narrative in the development community, and sometime practice, of citizen participation at the frontline of service delivery.
- Significant political and social action with respect to identity-based groups, historically associated with exclusions and deprivation, including blacks in South Africa, indigenous and Afro-Latinos in Latin America, and *dalits* and *adivasis* in India
- The continued existence (and probable rise) in the intra-state conflict and so-called "failed" states—with conflicts often coalescing along identity-based lines

Alongside all this, has been a more explicit concern with the "accountability" of the state—sometimes linked specifically to anti-corruption moves, but also, and more importantly, linked to a broader interest in state behaviour, sometimes associated with right to information and civil society actors.

How do these trends, and associated shifts in state-society relations, relate to the success or failure in human development? How to explain the persistence of fragile and weak state functioning?

It is useful to frame this in terms of two kinds of question. Does the underlying political equilibrium support broad-based social provisioning and regulation? And does the institutional (including ideological) and organizational functioning of the state—that is state "capacity"—support effective delivery and regulation? There is a parallel with the discussion of the nature of capitalism. The real, long-term question concerns the nature of the political equilibrium, the social contract between political and economic elites, and between the elites and various social groups, and whether this is consistent with state behaviour that delivers on public goods and services that expand opportunity for all; or not, but encourages extractive, predatory, or conflictive behaviours. At a point in time the "capacity" of state actors is a powerful influence on what can be done, and whether politically supportable intentions get distorted in the implementation process. "Capacity" is a nebulous concept, and is largely endogenous over the long-term, but it matters.

The remainder of this section presents an interpretation of the first three trends: exploring what historical experience indicates on the relationship between political "voice" and social provisioning; the role of direct participation; and the effects of politicization of identity-based groups. The question of state failure and conflict is returned to in the following integrative section on social contracts and typologies.

"Voice", or populist pressures on the state, are a primary driver of social provisioning—whether or not this is via formal democracy

Here's the thesis: that broad-based social provisioning occurs in response to populist pressure, in the sense of politically salient demands from middle and poorer groups on the state to deliver core services. This often implies some redistribution, and works best when there is an effective middle-poor alliance. This applies to all areas of social provisioning, though education also faces distinct pressures from the frequent desire of states to inculcate belief systems on the population. "Populism" is used in the broad sense outlined above. In practice politicians may adopt particular "populist" strategies that emphasize short-term payoffs to middle and poor groups, that do not take account of either fiscal constraints or distortions. It is this more restricted sense that the term is used in Latin American discourse (and often practice), as well as elsewhere (India for example). But this is not necessarily the case.

Since populist pressure is hard to measure independently, and is only weakly correlated with formal democracy, the most persuasive support for this thesis currently derives from historical narratives. An illustrative review follows.

First, in Lindert's analysis of the long-term evolution of social provisioning in now-rich industrialized societies, the expansion of political influence to working class men and women played a central role (Lindert, 2004). This was also manifest in a steady extension of the vote, though that was also to a large degree endogenous to rising political and social demands from below, or the political necessity of governments to deliver. Bismarck introduced accident, sickness and old age insurance during the 1880s, as a reformist response to the revolutionary threat from Germany's Marxist Social Democratic Party. The major extension of the British welfare state was framed in the Beveridge Report during the Second World War, and introduced as part an extended social contract, amid public debate on a "New Jerusalem", in the wake of the collective solidarity and sacrifice that the War had involved.

Second, in Engerman and Sokoloff's comparative analysis across the Americas, we again see more rapid expansion in the vote in the more inclusive societies, followed by expansion of education, and social provisioning for health and social security (see, for example, Engerman and Sokoloff, 2001, 2002). The United States (outside the South) and Canada were leaders, followed by countries in which European immigration accounted for the bulk of the population (Argentina, Chile, Costa Rica, Uruguay) and then by societies that historically had major, subordinate populations of indigenous or African slave origin (Brazil, Bolivia, Guatemala, Mexico, Peru). (Engerman and Sokoloff also have an important thesis on the origins of these political differences in terms of differential factor endowments around the critical juncture of European colonization, but that is not the focus here.)

Third, in twentieth century Latin America up to the present, the pace of catch-up in social provisioning, especially of lagging groups, is associated with the salience of political pressures from below. Mexico's revolution after 1910 provided a major push to broader provisioning in the subsequent political resolution—albeit under semi-authoritarian, "corporatist" lines, that also involved the preservation of the industrial oligarchy. In Peru it was manifest in a left-wing military coup under General Velasco 1968-1975, though subsequent developmental failures nurtured a virtual civil war with guerrilla groups. Both Mexico and Peru saw significant expansions in education, while Mexico developed an extensive social security system for formal sector workers. The 1952 Bolivian revolution was less effective, and major expansion in social provisioning was delayed till the 1990s. Guatemala was caught in a destructive and repressive conflict, and expanded provisioning was also substantially delayed till after the 1996 Peace Accords. Distributional and political struggles in Brazil were resolved by a right-wing military regime from 1964 to 1985: the subsequent return to and consolidation of democracy has been associated with a major expansion in social provisioning in the 1990s and 2000s, with the massification of education, and emergence of transfer programmes to the poor, such as the Bolsa Escola, now Bolsa Família, playing a significant political role.

Fourth, most East Asian countries developed political resolutions that depended on effective delivery to first the peasantry and then urban lower classes. This occurred both under communist auspices—in China and later Vietnam—and in Korea, Indonesia, Malaysia, and Thailand, where the centrality of a peasant political support base, and the threat of communism, were important to big pushes on broad-based social provisioning—as well as provisioning of productive services for peasant agriculture. In the latter, non-communist, group such broad-based provisioning typically went alongside old and new oligarchic structures—as in Mexico—though with more effective provisioning.

In Africa, the Zimbabwean and South African transitions to democracy led to major expansions in social provisioning for poorer groups, including attempts to level up to previously white standards in South Africa, for example in old age pension policy. Zimbabwe's has subsequently gone dramatically and depressingly backward, reflecting the incompleteness of the transition to an inclusive polity. In low-income Sub-Saharan Africa—outside conflict states—there has been steady expansion in social provisioning since independence, but this has often been slow owing to the weak state capacity.

In India, the post-independence ideology of universal provisioning of education and other basic services was implemented only slowly for decades, in spite of the importance of the poor vote. Especially in Northern States, this partial failure was a product of a state and society caught in structures of patronage and historically shaped social difference (PROBE team, 1999). Where social transformation proceeded further, in Southern states of Kerala and Tamil Nadu, social provisioning was more extensive. In the more recent past, the workings of democracy have led to elections of political alliances with a mandate for delivery of social and other services to the peasantry, that has led to substantial expansions of spending (in good and bad designs). Since the mid-1990s there has been large expansion in enrolments, to near-universal enrolment at entry. Bihar, one of the poorest and most educationally deprived states is a vivid illustration: following a change in power in the state-level 2005 election, there has been a huge expansion on spending in Bihar's schools, with the number of teachers tripling, after decades of neglect.

Education is also driven by ideological goals

Education is different from other forms of social provisioning. Schooling shapes beliefs, as well as imparting skills. Political elites have an interest in the beliefs of other citizens. Many governments have explicitly used education to support the belief systems and forms of citizenships that the political elites favour—whether of modernization in Meiji Japan, secular principles in Ataturk's Turkey, republican France and Mexico, or an ideology of cooperation and Indonesian nationalism (and not communism) under President Suharto. This is an important reason for governments choosing public delivery over public finance (Pritchett, 2002). Religion can also be a factor, irrespective of government. Some religions place emphasis (in particular phases) on reading. The Lutheran Reformation pushed reading the bible in the native language, as opposed to listening in Latin. That was good for literacy, and a positive Protestant influence on growth, to the extent it existed, may have been mediated via education, as evidenced by inter-regional variations in Protestantism, literacy and growth within Prussia (Becker and Woessman, 2010). (There is, however, effectively no evidence for the *general* argument for a cultural-religious influence on long-term growth, but that's another story; see Sen, 2003).

Broad-based intentions on social provisioning can be consistent with specific exclusions and inequalities

Even where there is a societal deal, including elite support and de facto government commitment, for some kind of broad-based social provisioning, this can be associated with substantial inequalities in access and outcomes across social groups. A classic example lies in the inequalities in social provisioning between the households of formal and informal workers. In most developing countries, some form of risk management is embodied in formal labour contracts. For example, Mexico's formal social insurance system applies to public and private workers with contracts. This includes retirement pensions, health insurance (in dedicated hospitals), work-risk insurance, life insurance, disability insurance, day-care for workers' children, sports and cultural facilities and housing loans (Levy, 2008). Workers without formal contracts get much less, and what they get is of lower quality. Yet this all fell within an ideology of inclusive social provisioning, bred of the 1930s resolution of inter-group conflict in the Mexican corporatist state. Of course, organized workers had much more leverage than informal ones in the deal—this was underwritten by a narrative of social provisioning that goes back to its Bismarckian foundations. With the transition from a semi-authoritarian system to democracy in the late 1990s, there was a marked increase in social programmes for the households of informal workers.

A similar story applies to the formal-informal divide throughout the developing world, though in poorer countries (such as India) formal workers are a minority. In others (many in Sub-Saharan Africa) formal social insurance systems collapsed in any case.

Expanded provisioning works best when aligned with state capacities

A further consideration is of capacity. Even where the political equilibrium is supportive of broad-based social provisioning, the effectiveness of this depends on alignment with the capacity of the state to actually deliver—when the state is the central provider. In some of the major historical successes this was clearly the case. The expansion of education in the United States occurred initially as an essentially local movement, with local demands effectively pressuring local governments to deliver education of decent quality to the children of mainly white middle and working class groups (Goldin and Katz, 2008). The history of black education is, of course, thoroughly different, both before and after the Civil War in the South, as dominant white groups largely excluded blacks from decent education until the civil rights movement of the 1960s, with a continuing heritage today. I have not reviewed careful analyses of the state education service in other big successes, such as Korea and Cuba, but would expect similar conclusions: a close alignment between incentives for teaching, internal governmental processes, ideologies of educational quality and societal pressure.

On the other side, many countries have been successful only with those aspects of social provisioning that can be undertaken with top-down, often patronage-based, state systems. Education again exemplifies. Expansion of schools is relatively easy to do in a top-down fashion, and is often politically aligned: teachers unions like expansion, as do contractors. Brazil, India, Indonesia and Mexico found it relatively easy to expand enrolments in basic education, when the overall political equilibrium supported this. However, what has proved to be much harder in each of these countries (and elsewhere) is developing the incentives and work culture that solves the challenge of getting motivated teachers to impart real learning skills to kids. Solving incentive problems for managers and workers is always hard in the public sector. It is especially hard when the state is embedded in patronage-based mechanisms of channelling goods and services to core supporters, along the way creating new entrenched groups, with an interest in maintaining their rents (in economic language) or opportunity-hoarding (in the language of sociologist Tilly, 1998). (I expand on the role of rents in the final interpretative section.) This is particularly hard when teachers have a premium in salary over alternative occupations with similar characteristics, as in India and Mexico, and where there is effective resistance to linking performance and career to actual results in school (see Pritchett and Murgai, 2007, on India).

The issue of weak state capacity is particularly germane to low income countries, many of which are in Sub-Saharan Africa. As already noted, at a point in time this can be largely exogenous, but it is also a product of political and organisational histories, apart from longer-term influences of educational investment. In particular, where governmental systems have shifted into relatively extreme, short-term forms of rent-seeking, often exacerbated by falling government wages and inter-group distributional struggles, "weak" capacity or effort can become an apparently ingrained feature of the state. On the other hand, there is evidence of specific government services substantially improving their performance in response to better information and social pressure. Two Ugandan examples illustrate: in the first informational campaign on how much budgeted money actually arrived in schools had a dramatic impact on reducing leakage (Reinikka and Svensson, 2005); in a second case, provision of monitoring information on public dispensaries provided to local user communities had a significant effect on the effort of government workers, utilization and health outcomes (Bjorkman and Svensson, 2010.)

In other domains, the general phenomenon is reflected in the classic contrast between investment—relatively easy to build irrigation channels, open water supply and hospitals, where there is often alignment with politician incentives and contractors' profits—and maintenance--where it is hard to get the incentives systems that keep the water flowing, nurses working well and medicines coming.

State capacities and interests can interact, for good or ill, with institutional design choices

Sometimes specific design choices make a difference. A big example is the common policy amongst developing countries—from Latin America to Korea—to follow an essentially Bismarckian design in the provision of social security, already cited above. By this I mean linking pensions, worker accident insurance and health insurance to labour contracts. This is bad enough when most of the workforce is in formal work. It is pernicious when most work is informal. This leads to dualistic provisioning, with households dependent on informal work often facing little or no formal mechanisms for risk management. (Yes, there are sophisticated informal mechanisms, but these have costs, are bad at dealing with covariate shocks, and suffer different patterns of inclusion and exclusion, linked to social status and networks.) It provides a disincentive for firms to offer formal contracts—especially where these have additional costs of separation, and where there are minimum wages—and for workers to choose them—especially when their valuation of the offered benefits is lower than the cost (Levy, 2008). And it again creates groups with an interest in entrenching their position—both those who receive the benefits, and workers on the supply side of the social security system. In Mexico, for example, the social security system for private sector workers (*Instituto Mexicano del Seguro Social*, or IMSS) is one of the biggest employers of its own workers in the country. The union of IMSS workers fought a fierce political fight in the mid-2000s to maintain benefits substantially higher than those received by the private sector workers in the system.

While the UK's welfare state is not often cited as a paragon of efficiency, the underlying principle of the Beveridge report, on which the post-Second World War expansion of the welfare state was based, was of tax-based, universal provisioning, especially for health, unemployment and basic pensions. Design details matter a lot—and there have been incentive problems in the British system—but these core principles offer a better model. It is unlikely that the designers of India's National Rural Employment Guarantee Scheme were looking to Beveridge. But the NREGS is an example of a tax-financed design that is aimed precisely at informal rural workers, and through provision of a guarantee has potentially good insurance and incentive properties.

Effects of local participation depend on local context

Local participation, often linked to greater decentralization to lower levels of government, is a second trend that is highlighted here. It is of interest to this essay as an institutional mechanism that will induce greater responsiveness and accountability of government to voters or recipients of services. In a world of rule-bound bureaucracies pursuing the objectives of politicians and managers, local participation can be seen as a source of better information on local preferences, allowing greater alignment. However, such a world is far from the typical developing country reality. And the more common rationale is as a source of "empowerment" of citizens, whether amongst the poor or non-poor. This seems consistent with examples such as participatory budgeting in Porto Alegre, in which citizens have a direct say in budgetary decisions, or the EDUCO (*Educacion con Participación de la Comunidad*) schooling design in El Salvador, in which parent committees have the power over recruiting and firing teachers.

This is not the place to review the balance of evidence in this area. I rather want to make two points. First, the effects of either direct participation or decentralization are highly dependent on the local social and political context; it is easy for such shifts to get stuck in a local unequal equilibrium, as opposed to inducing a shift to a different equilibrium, that is more equitable, or is better at delivering public goods. Second, local functioning is closely connected with national, or at least higher level, policy and political processes.

Take the case of Porto Alegre. In-depth studies (Abers, 2000) suggest that this did have transformative features on how the city functions and on the nature of interactions between local groups and the local state. There were substantial shifts in expenditure allocations, high levels of mobilization, especially in poorer neighbourhoods, evidence of better overall city functioning (including higher tax payments), and documentation of participating individuals experiencing a sense of psychological empowerment. But this all has to be seen in a larger context. Brazil had experienced a recent return to democracy. Changes in national rules led to substantive decentralization to cities. There were well-developed local social movements, emerging from the democratization struggle that was relatively encompassing in character. A left-wing political party, the *Partido dos Trabalhadores* (PT, or Worker's Party), won a local electoral context, and then became pragmatic in office. This was a mix that supported new alliances and strategies when the PT came to power—a local critical juncture. There is some quantitative evidence that participatory budgeting has an independent effect when it has been adopted elsewhere in Brazil, but measurable impacts are modest rather than transformative.[7]

In other cases decentralized social and political structures can be a source of perpetuation of inequalities and exclusions. A classic example is way in which the US South was able to reconstitute highly unequal social structures, maintaining subordinate status of blacks, after the Civil War—with substantial change coming almost a century later, effected by the interaction between social movements and Federal action (Robinson, 2008).

At a more local level, Abrahams and Platteau (2003) argue, on the basis of a review of devolution of funds to local communities in Sub-Saharan Africa, that this typically becomes embedded in local socio-cultural practices, whether this involves "traditional" patterns of ascribed social position, or patterns of differentiation in social and economic status that occur as marketization and economic development proceeds. Absent other sources of change—from external change agents—the most common outcome is reinforcement of existing inequalities and practices.

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[7] The econometric design sought to isolate the effect of participatory budgeting (or rather a participatory budgeting plus PT government) through comparing marginal election results in which the PT just won or just lost (Baiocchi et al. 2006).

There have also been ambiguous effects from the 1993 constitutional change in India that led to a formal devolution of political authority to village council (*panchayats*) with some modest budgetary control. This interacts with the nationally legislated policy of rotating reservation of the elected village leadership to women and individuals with scheduled caste or scheduled tribe. This has in some cases led to the emergence of new deliberative practices, in which the very process of interaction appears to be changing local discourse (Rao and Sanyal, 2008). There is also some evidence of shifts in budget allocations, for example, with elected women leaders (Chattopadhay and Duflo, 2004). But it is still unclear whether this has been a source of local transformation. Also in India, one study finds that the introduction of village education committees as part of a major nationally financed education programme, channelled through the states (the next layer of government), had no effect: parents in the study area of Uttar Pradesh were essentially ignorant of VECs, and there was no evidence of impacts on outcomes (Banerjee et al, 2010, who did, however, find evidence of impact of a volunteer-based teaching in the same study).

A final set of examples also comes from Brazil. Tendler's (1997) study of a range of changes in the highly unequal, clientelistic state of Ceará, indeed finds substantial improvements in service delivery, in health, extension service, small-business, associated with both new cadres of workers (the village health workers) and changes in the management of public sector worker groups (e.g. extension workers). This involved shifts in front-line interactions between the government workers and the households and communities they served. She diagnoses this as a product as coming very much from interventions from above, from an activist state government (also a contingent product of state level elections and representatives of modernizing local elite elements coming to power). Sometimes this involved the external introduction of recruitment practices—of the VHW cadre—to avoid traditional practices of local clientelistic job allocations.

Identity-based movements are of rising political salience, and sometimes conflict

A third trend highlighted here concerns the political position of previously excluded and subordinate groups. The past 20 years or so has witnessed the rise in voice, in political salience, of several socio-cultural groups that had historically suffered substantial discrimination—sometimes referred to as horizontal inequalities (Stewart, 2001). These include the transition from apartheid in South Africa, the rise (or re-emergence) of indigenous social movements in Latin America, that translated into political parties associated with these movements coming to power in Bolivia and Ecuador, and the growing importance of lower caste politics in India, with increasing frequency of political power at the state level of parties associated with "other backward castes" (outside the Brahmin and merchant elite) and more recently *dalits* (in the form of the BSP, or Bahujan Samaj Party, currently in power in Uttar Pradesh).

Three issues are of particular relevance to this essay.

First, political organization—generally under democratic auspices or in democratic transitions—has been an important feature of this phase in the rise of influence of these groups. Moreover, the dynamics of change seems to be distinct when action flows from political mobilization than when from national policy. As an example, in India Banerjee and Somanathan (2007) find relative gains in local public good provision in local areas with significant proportions of scheduled castes *(dalits)* but not scheduled tribes (*adivasis)*. They suggest this is linked with the emergence of political alternatives of the Congress party for *dalit* voters, that has not effectively occurred for *adivasis.* Similarly, in Latin America Afro-Latinos have had much less success in political organization, and are much less politically visible.

Second, issues of symbolic recognition matter. In India again, parties associated with other backward castes and dalit-based parties initially put major efforts on policies associated with "dignity". Alejandro Toledo, the first indigenous president of Peru (and only the second of Latin America) held a second inaugural event, involving a traditional ceremony and priests.

Third, relative economic and social disadvantage is persistent. This is seen in the continued relative position of dalits and adivasis in India, of indigenous groups in Latin America and also of blacks in the United States. Structures of inequality are remarkably persistent. They are also not necessarily dissolved by market/capitalist processes: firms considered modernizing in India continue to practice differential higher practices (Thorat and Newman, 2009).

4 Interpretation: social contracts, typologies and transitions.

Let's return to the major theme of this essay. It is that success and failure in human development is a joint product of capitalist dynamics and state functioning. However, the big issue is not state versus market, or growth versus equity, or dynamism versus security. It is the jointly determined functioning of both capitalism and the state. This is a consequence of the extent to which both capitalist and state behaviour is oligarchic, extractive, exploitative and divisive as opposed to being inclusive, innovative, accountable, responsive and effective at mediating distributional conflict. This can be conceptualised at a point of time in terms of the nature of the political equilibrium, or, alternatively, the way in which social contracts work. This is a product of the historically shaped interaction between political and economic elites, and between these and various social groups.

The oligarchic-inclusive contrast should not be seen as a simple dichotomy, any more than state v. market. There is a wide range of configurations. Furthermore particular designs can of course involve some of the classic tradeoffs—of an overbearing state suppressing private initiative, of redistributive measures reducing incentives or inducing conflict and so on. Examples of mixes suggested in this review include:

- Failed and conflict-ridden states, where there are neither institutional or informal enforcement mechanisms even to credibly protect the property rights of specific economic elites, or to manage distributional conflict without violence. Incentives in this context are for short-run predation, extractive endgames and fighting to loot.
- Narrow oligarchic regimes that are functional but involve highly extractive and exploitative economic structures, necessarily backed by political repression (Mobutu-Zaire)
- Broader oligarchic regimes with a functional oligarchic capitalism (Brazil, Mexico, the Philippines)—sufficient to provide credible commitment for core investors, but with significant levels of capture undercutting dynamism, and with varying, and often dualistic levels of social provisioning. Given the pervasiveness of patronage and clientelistic political mechanisms, under both authoritarian and democratic auspices, this is often

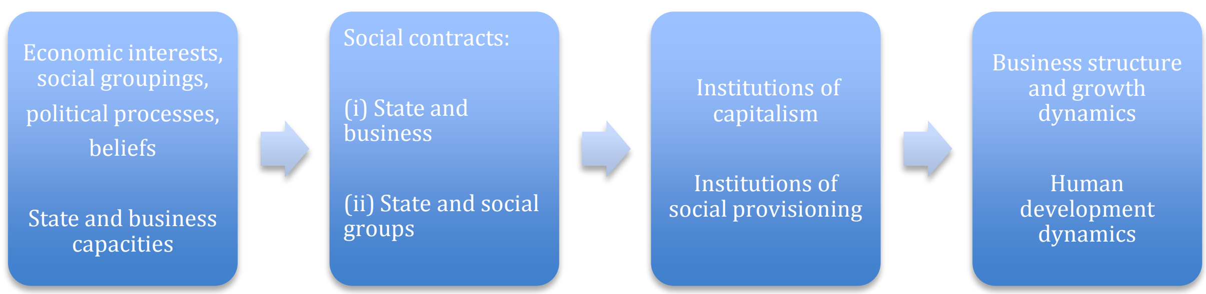
associated with weak incentives for performance amongst state managers and frontline workers.

- The non-communist East Asian brand involving a mix of oligarchic capitalism and a state beholden to broad-based interests of the peasantry and urban middle and poorer groups. The communist countries of China and Vietnam are now effectively in a similar position, but arrived there from a different route. Some East Asian societies—Korea, perhaps Taiwan—appear to have made a transition to a more open political system, that could lay the basis for true prosperity.
- A democratic version typified by India, contemporary Latin America, many parts of Africa, in which procesual democracy is overlaid on a mix of oligarchic and entrepreneurial capitalism, with often an added blend of identity-based differences. Populist pressures working through formal democracy and other means can support good outcomes (broadening of health insurance, NREGS in India, Bolsa Família) but also frequently leads to clientelistic policies.

So how can we think of this range of conditions? Consider the varying forms of political equilibrium as reflecting underlying social contracts between the political and economic elites, and between elites and different social groups, with state actors (that partly overlap with political elites) playing a central role in this interplay. The interactions, and associated distributional fights, are deeply about processes that create, extract and share economic rents. The (in)stability, incentive and distributional properties are crystallized in institutions—both formal and informal, ranging from constraints on behaviours to belief systems.

A simplified schematic is given in Figure 3. This is, of course, a large abstraction from a much more complex reality. It suggests a central channel of causation, from underlying social, economic and political processes through social contracts and institutions to human development outcomes. I would highlight three aspects of this formulation: (i) putting some structure on an "institutions matter" approach; (ii) using the idea of social contract—as here framed in terms of a functioning political equilibrium—as a way of interpreting the underpinning and stability of institutional resolutions; and (iii) the role of business and state capacities, that are historically formed, but shape options and resolutions. The last point is particularly relevant given an organizing prism of the social contract for two inter-related arrangements, between state and capitalists, and between state and social groups. Of course, there are different types of capitalists—large scale, foreign, informal—and there are definitely different social groups—middle households, working classes, groups with a socially stigmatized, inferior or exclusionary identities—and so on. This all matters, but I want to start with a more parsimonious account.

Figure 3. A simplified schematic of causal processes



Source: author

With this framing, I discuss a set of issues around the nature of the social contract that shapes economic and social dynamics. This is done in three parts: first I pose some questions around the big issues; then turn to the vexed question of typologies in relation to human development progress; and finally I consider transitions.

On social contracts between the state, capitalists and social groups: some questions

Can the state, and political elites, credibly commit not to expropriate the property rights of (some) investors?

In their historical analysis of Mexico during and after the revolutionary period, Haber et al (2003) argue that this central issue starts from a core paradox: that a state that is strong enough to protect property rights is also strong enough to expropriate them—that is to renege on a commitment. The long-term resolution of this problem is seen in now-rich countries in the functioning of effective, politically supported, institutions that limit opportunistic government behaviour, including checks and balances from legislatures, judiciaries, sometimes state rights, and a range of more specific regulatory structures. Of course, these don't always work well in rich countries, as the distorting influence of interests in the US in finance and health vividly illustrates. Nevertheless, they have worked well enough to support transitions to high levels of prosperity. However, transplanting the organizational form of such structures will be meaningless if inconsistent with the internal social contract. Haber et al argue that resolutions in Mexico occurred through the emergence of third-party enforcers, that in some phases were quite contingent (military groups, favoured worker unions), but became increasingly institutionalized over time in the formation of corporatist structures that led to some automaticity in rent-sharing for the various groups. Rent creation and rent-sharing lie at the heart of this, to ensure groups with the power to disrupt have a stake in existing arrangements. An analogous story could be told on the deal struck in Indonesia between the Soeharto-led military regime and the Chinese business groups—large rents were created and shared between these groups, and both sides had the capacity punish the other: the Chinese through capital flight, given the opening of the capital account at the beginning of the Soeharto era. The issue is not the particular form of the, often implicit, contract. It is that absent resolution of this issue of credibility in commitment the prospects of substantial private investment are dim. The mechanisms vary. And often they will only apply to certain groups, as established capitalists in Mexico, or to particular spatial areas, such as extractive enclaves in many parts of Sub-Saharan Africa, that Ferguson (2006) argues is a central feature of the form in which globalization is manifest in many countries of this region.

What do alternative resolutions imply for the time horizon of elite behaviour?

This is a specific aspect of the credible commitment issue. The social contracts that evolved in Mexico under the PRI, in Indonesia under Soeharto, in Thailand until the recent period of turbulence, in India and China over decades, have been consistent with political and economic elites having long-term time horizons. This has typically been backed by nationalist ideology and associated belief systems. There is certainly short-term rent extraction along the way. In some cases authoritarian or repressive action can stoke longer-term grievances. But there is also credible commitment from the state to investors, including over the management of the part of the social contracts that relate to social groups. An interesting African example is that of Ethiopia: the semi-authoritarian regime that has involved under Prime Minister Meles Zenawi is controversial because of disputed elections and accusations of bias toward certain groups. However, most observers would agree that Zenawi has the goal of being in charge for the long haul, with the economic and social transformation of Ethiopia as central objective. Whether this government has solved issues of credible commitment to private investors and distributional conflict is another matter.

What is the balance between extractive rent-sharing with cronies and incentives for dynamic rent creation?

This is related to, but distinct from, the time horizon question. The Philippines and Mexico have for a long time been societies in which the nature of the rent creation and rent-sharing was closely tied to the creation of monopoly rents, that involve extraction or exploitation of other groups. These were resolutions with long-term time horizons and so could sustain slow growth, and were associated with unequal political structures. Mexico now represents more of a mixture: competitive sectors exposed to internal and international competition, especially via NAFTA, and a range of de facto nontradable sectors with substantial monopoly rents. Many of the latter are associated with Mexican billionaires. Now these probably have long time horizons but are effective at extracting rents from firms and citizens in Mexico. Other resolutions involve short-term extraction and sharing—especially in a situation of conflict or uncertainty (Pakistan today?) So the really interesting question is what will induce the state and business to shift their social contract to one that involves open economic institutions and incentives for pursuit of Schumpeterian rents?

Is the resolution for political and economic elites associated with extractive or inclusive relations with middle and subordinate social groups? And how do they credibly commit to provision for such groups?

This is fundamentally the story of social pressure from middle and subordinate groups, linked in the now-industrialized countries to the steady evolution of democracy, and also associated with the threat of revolution. The discussion of the relationship between voice and social provisioning above exemplifies this. Acemoglu and Robinson (2006) have argued that elites agree to democracy as a commitment device—otherwise the masses will not find credible the introduction of policies for sharing of wealth, consumption or services in the current period.

Throughout East Asia, the political success of communism in China proved a powerful spur to non-communist countries to deliver material and social benefits to the peasantry.

What is the balance between clientelistic relations and provision of public goods for different social groups?

At one level the form in which provisioning of goods and services is a more subtle issue—second order to whether political elites commit to deliver to middle and poorer groups. But it is both pervasive and fundamental. A clientelistic resolution is the most common, seemingly natural, equilibrium for long phases of development. This involves a reciprocal relation: goods or services for political support, whether in the form of votes or other mechanisms of providing loyalty. This may involve private goods for favoured groups, such as in public sector jobs. For example, in negotiations over group, or even family-based, grievances in India, it is common to demand, and receive, a public sector job guarantee. It can also involve "club" goods to particular villages, slums or groups, such as roads, water supply, promises to regularize and so on.

Clientelistic inclusion is not all bad, since it does at least bring poorer groups into the political system and provide services. It was an important form of inclusion of immigrants into US cities, for example. But it is typically unequal and asymmetric, embedded in a contemporary form of patron-client relations, and tends to undercut the independent agency of social groups. Of equal importance is the bias against provision of general public goods, whether at the local or regional level. Classic transitions occur with the emergence of more programmatic parties, but effecting change during the development process can be hard. Stokes (1995) has a fascinating discussion of the transition from a clientelistic political culture to rights-based approaches to seeking service provision from the state in Peruvian slums in the 1980s (though this was swept aside by the authoritarian populism of Fujimori). In terms of the capacities of subordinate groups, this is closely linked to Appadurai's concept of "the capacity to aspire" that he developed based on observation of processes of social activism in Mumbai's slums: this is an essentially culturally-based capacity to conceive, envision and act upon trajectories of social change, built by group-based action in struggles for both practical services and rights, ranging from toilets to legal recognition (Appadurai, 2003).

How is conflict managed?

The issue of how conflict between groups is managed is at one level the first order issue—whether this is between business and labour, or between different identity-based groups. North et al (2007) build a whole conception of modernization in terms of the management of threats of violence by the state. This obviously matters for societies in violent conflict. It is also relevant to non-violent conflicts, for example around loss allocations in the wake of shocks: Rodrik (1999) argues in an empirical treatment that long-term growth impact of macroeconomic shocks of the 1970s and 1980s were mediated by the interaction between underlying societal polarization and conflict management mechanisms: countries with high levels of polarization and weak mediation structures—typified by Latin America in the 1980s—suffered long-term growth costs.

How institutionalized are checks and balances on opportunistic behaviour, both in the sense of formalization of institutions and incentives (from punishment or social internalization) to respect them?

Rapid human development is clearly feasible in the absence of consolidated, open political and economic institutions, as many examples of rapid advances under oligarchic capitalism and authoritarian political institutions illustrate. But these are argued here to be intrinsically fragile—contingent on the incentives and capacities to enforce punishment of opportunistic behaviour by different groups, or of the state to maintain control. Where these are robust, and credible, this can last for decades—as with Indonesia under Soeharto, Korea under authoritarian auspices, Brazil under the generals and so on (through to China now?) But real long-term change depends on institutional consolidation—in other words in the formation of institutions that crystallize incentives and punishment mechanism both through formal structures, and often in internalized social norms. One interpretation of the "middle income trap" is of the failure to effect this transition. But this is not just a step on a modernization path. Such institutional shifts are also relevant for poorer countries: consider, for example, the emerging role of social audits in India, that is designed to play a central role in the recent National Rural Employment Guarantee Scheme, as a means of preventing re-capture by alliances between corrupt local state officials and corrupt contractors. Again, what is of interest is not finding institutional tricks that can be transplanted, but understanding the circumstances and designs that will support such institutional consolidation. Think of central bank independence—a favourite example of desirable institutionalization. Yet both anecdote (Argentina and Zimbabwe have, or had, independent central banks) and empirical work (Acemoglu et al. 2008) suggests this worked only when politically supported.

Typologies—of functionalities not form

Let's now take an integrated view on the varieties of institutional structures. The central notion is that sustainable success—whether in terms of capitalist dynamics or social provisioning—depends on a working social contract, or rather (in the stylized partition used here) in two social contracts, between the state and capitalists, and between the state and middle and poorer social groups. The form of these social contracts varies, but the function is common—a credible, long-term commitment to deliver by the state, implying that this in the long-term interests of political elites, that conflicts can be managed, that opportunistic behaviour will be costly and that there is good-enough capacity to deliver—on the part of the state, and, indeed, by capitalists. This characterization focuses on the existence and enforceability of social contracts—the second box in Figure 3.

Now can anything sensible be said with respect to patterns of international experience? A simple formulation of the thesis is as follows: a functioning state-business social contract is conducive to capitalist dynamics and a functioning state-social group social contract is good for social provisioning; capitalist dynamics and social provisioning then interact in the determination of income and non-income dimensions of long run human development. The problem is that it is hard to get an objective, exogenous measure of such social contracts. In recent empirical explorations of the relevance of institutions (e.g. Acemoglu et al 2004, Banerji and Iyer, 2005) there has been exploitation of historical accidents and credible associations between correlates of "institutions" and some exogenous factor. But that tells us little or nothing about mechanism. Thus the heuristic emphasis here on (highly abbreviated) accounts of narratives—Haber et al (2003)'s in-depth account of Mexico being an exemplary case. But since this is an essay, I'll continue to make speculative comments on patterns.

Take a categorization of dynamic patterns using a division of the human development index between growth in incomes per capita and the (remaining) index of health and education. Appendix 1 provides a four-way partition of country experiences between 1970 and 2007 from the Human Development Report office, organized in terms of outcomes over time, and divided between cases that were above the median on both dimensions (a "virtuous" development process), neither (a "vicious" process), only health and education (an "HD lopsided" process) and only growth in incomes per capita (a "growth lopsided" process). This categorization has similarities in spirit to that used by Drèze and Sen (1991) that was in preparation in parallel to first Human Development Report, and was based on in-depth country narratives with a strong emphasis on considerations of security-related provisioning. Drèze and Sen used the term "growth-mediated security" to characterize development paths in which growth went along with, and helped support, strategies of broad-based social provisioning, "support-led security" for cases in which direct action occurred prior to, or in the absence of, major growth, and "unaimed opulence" for countries that prioritized growth and neglected the security for the population.

"Virtuous" processes.

This happy mix would be expected to involve credible commitment, a state with enough countervailing power to avoid predatory capitalist practices, good-enough capacity of business and state, a socio-political resolution for broad-based provisioning, a capacity to manage distributional conflict and enough pressures structural change and innovation. It will typically involve rents and rent-sharing—indeed rent-sharing, between political and economic elites, and between competing social groups, will typically be functional to the political equilibrium, that is to the stability of the social contracts.

Let's look at the long, outcome-based list from the HDR to see if there is any correspondence with this mix. This includes both communist (China and Vietnam) and non-communist East Asian successes, as expected. It also includes all the more stable Latin American countries, including Brazil, that was actually an exemplar of "unaimed opulence" for Drèze and Sen. Then there are South Asian cases (India, Bangladesh and Nepal), the more successful North African and Middle Eastern cases (Morocco, Tunisia, Egypt), Turkey, plus Laos and Cambodia. The list covers stars and those just above the median, so there's a lot of variation. But there's a plausible case to be made that the majority of these fit the story developed here.

The communist successes of China and Vietnam have a long-term political and ideological resolution in favour of broad-based social provisioning for the masses.[8] The shift of the past 30 years has been to get their own version of resolution of the credible commitment problem with private, or private-like, investors. Business deals may often be murky, and corruption is widespread, but returns on investments are generally secure, governments deliver on local public goods, and costs of doing business are reasonably low by international standards. There is tremendous capitalist dynamism in a blend of oligarchic, state-owned and small-scale entrepreneurial forms.

Non-communist East Asian countries include the classic stars. I would highlight here the diversity in the *form* of the resolutions, with the two examples of Korea and Indonesia. Korea is an exemplar of Evans "embedded autonomy", thick with economic and political rents, with government-chaebol cooperation at the core. A powerful executive, and effective bureaucracy countervailed oligarchic capitalist structures, and supported a combination of domestic economic rents with pressures for external competition and innovation by the chaebol. At the same time there was enormous social and political pressure for economic and social advance, driven by the communist threat and the aspiration to catch up (not least with Japan). Strong social pressures supported practical resolutions of high quality social provisioning, both over the long term (with excellent education) and in protection in the wake of the East Asian crisis. The seeds of this crisis lay in the downside of the oligarchic capitalistic structure of the chaebol: weak governancee, resilience to takeover, and lack of disciplining from market or institutional shareholders. As they expanded, their relative power rose, in relation to state-owned banks and bureaucracy, and this allowed them to borrow cheaply, at home and abroad, to support ambitious expansion plans.[9] The social contract between state and capitalists had continued to support

[8] There are of course many issues, for example around the stagnation of health indicators post-1990 and the differential treatment of internal migrants in China, but the intention is to give a broad assessment; moreover these, undoubted, problems have not threatened the social contract in this period.
[9] For a summary interpretation see Johnson and Kwak (2010)

dynamism, but had by the 1990s also underwritten excessive risk-taking, in addition to an array of rent-sharing and intermingling amongst elites.

Indonesia had a more conflictive post-independence history, that reached a head in the social conflagration of the mid-1960s. Out of this emerged a new political equilibrium that supported economic and social advance for almost four decades. The deal between political-military elites and the Chinese capital was at the core of the first social contract; at its core was a self-enforcing deal in which each could credibly punish the other party. It is obvious that the government could expropriate the Chinese business. But Chinese capital could also threaten to flee the country, and the Soeharto government's early decision to open the capital account made this threat more credible. It was indeed acted upon at critical moments in Indonesian history. With respect to social provisioning, the regime had a political necessity (given the communist threat) and also an ideology of delivery and local social reliance. While government capacities were weak, and corruption institutionalized, the state was good enough to deliver on schools, roads, health clinics etc, if not so good at solving quality problems. Rent extraction and sharing was a feature throughout, and almost certainly became worse in the 1990s, as opportunities increased and checks and balances diminished, and this laid the base for the bursting of the political bubble in the East Asian crisis, that fostered the subsequent transition to democracy.

So how do Latin American countries compare? Given their reputation for high inequality and macroeconomic instability there membership in the "virtuous" group may be a surprise. Of course, this group includes both stars and more regular performers. However, from the perspective of this essay, three things are relevant.

First, many Latin American countries did indeed successfully resolve the credible commitment problem for significant parts of the 20th century, often in the context of restructured alliances (and intermingling) between political elites and the emerging industrial elites. That is at the core of story of Mexico that is developed in depth by Haber and co-authors (2003, 2006), with parallels in the other more stable countries of the region. Brazil and Mexico both had their miraculous growth. Much of Latin America is middle income precisely because of such a historical resolution.

Second, this resolution had (at least) two typical weaknesses. It was overlaid on distributional struggles—weaknesses in the second social contract—that led to periodic bursts of short-run populism, not least in its macroeconomic incarnation that led to national debt crises. And second, the checks and balances, whether from the state or economic institutions, were weak—leading to a bias toward rent-extraction and sharing of monopoly rents over creative-destruction. This worked relatively well in import-substitution phases, but not beyond, and also slowed the development of more vibrant business capacities. This is an important factor behind the "middle income trap" illustrated for Mexico in Figure 1. Washington Consensus type reforms can help, but often did not tackle the fundamental weakness of this state-business social contract.

Third, the state-society social contract in favour of broad-based social provisioning—always strong in Costa Rica and Uruguay, and half-hearted in Mexico—became more salient with the transition to democracy. Brazil is an interesting case here. Apart from extreme income inequality, it also lagged dramatically in educational status through the 1980s. The transition to democracy was based on a broad-based coalition of social groups, and reflected in the new 1988 constitution, that affirmed an array of social rights. Brazil also has a reasonably high degree of state capacity. The fall out was a steady expansion in social provisioning over the 1990s and 2000s, in, for example, the social pension for farmers, the massification of basic education, and the experimentation and spread of conditional cash transfers, latterly in the form of the *Bolsa Família* under the government of President Lula da Silva. Even income inequality has fallen significantly in the 2000s.

India provides a further example—common functionalities, different forms and histories. Here the post-independence resolution was ideologically in favour of redistribution and broad-based social provisioning. It was also increasingly statist, in terms of selective state-ownership and regulation of a family-based business sector with substantial, historically formed capacity. The irony is that both social contracts did poorly in implementation. Social provisioning was slow, a consequence of entrenched inequalities, distributional fights, and a patronage-driven public service. (It was indeed better in the Southern states, where some of the distributional fights, in favour of the advance of lower caste groups, were resolved earlier.) Capitalist dynamics were also slow, caught in the web of license raj, channelling energy into rent extraction and rent-sharing within this constrictive frame. The transition to a "pro-business" position, with the 1991 macroeconomic crisis and liberalization a point of inflexion, marked a shift in the implicit social contract with business, that also induced substantial new entry, major innovations, alongside a substantial increase in profit shares, a surge in the number of billionaires and concerns over the influence of the business oligarchy. In the social domain, democratic process has put consistent pressure to tackle inefficiencies and inequities in social provisioning, and, especially in the 2000s, has led to major expansions in basic schooling, signature programmes for risk management, including the National Rural Employment Guarantee Act, but still suffers from deep problems of a "weak" state, whether due to the mix of patronage and a system with little of no incentives to actually deliver services to clients.

Other cases represent more of a mix. Bangladesh looks like a genuine exception to the story here: substantial progress despite a weak, corrupt state. There has been sufficient credibility in commitment to some labour-intensive industries, notably in garments, despite poor public good provision. But the more remarkable story is how NGOs, such as BRAC, have managed to fill the vacuum of state ineffectivess in many areas of social provisioning. Nepal is an interesting case of a country seemingly mired in conflict that nevertheless made rapid progress. Its success makes sense in terms of very low starting conditions, severe social injustice and a quasi-feudal oligarchic system, that met rising expectations and mobilisation, with the Maoist insurgency the violent end of this. Political support for expanded social provisioning was, in part, a defensive response—backed by high levels of donor activity. A "weak" state was good enough to deliver big gains, especially in education, in the relatively easy stuff of getting kids into school. This was accompanied by steady, unspectacular growth, despite continued uncertainty and the dominance of a local business oligarchy. Finally, the cases around the Mediterranean plausibly had a political imperative to deliver to their populations, yet also had a functioning arrangement with their private sectors, but this would require further investigation.

"HD lopsided"

Drèze and Sen's theme of "support-led security" carried the message that broad-based social provisioning was practically feasible at low levels of development via state action; it was not necessary to wait for growth. Exemplary cases were China, Costa Rica, Sri Lanka, Chile and Cuba, all of whom had unusually good social indicators for their income levels. Many of these have since transited to "virtuous" paths. Cuba is a case of a growth failure that nevertheless did remarkably well on education and health. Those on the new list also look more like cases that had an internal social contract that led to social provisioning, backed by "good-enough" state capacity, but that have been long-term growth failures. The Latin American cases—Bolivia, El Salvador, Guatemala and Nicaragua—all have experienced democratic transitions, and associated pushes on social provisioning, but have suffered from a combination of major distributional conflicts, around identity and class, and longer term histories of small, oligarchic family control of both economy and polity. That's a tough basis on which to reconstruct the social contract with business in favour of stability, innovation and dynamism. The Middle Eastern and North African cases have either weak or antagonistic capitalist traditions. The current Iranian regime was born in reaction to an unequal oligarchic precursor, and has combined being restrictive of capitalist advance with a substantial effort to deliver to middle and lower social groups; evident, for example, in the large gains in education, for both women and men. Philippines is a classic case of oligarchic economic dominance, but a long history of relatively good social provisioning, especially in education.

"Growth lopsided"

This group also looks rather different from the "unaimed opulence" category of Drèze and Sen. In fact it is dominated by two categories. First there are former communist countries who had initially very high levels of human development in terms of education and health, and experienced (eventually) some growth recovery. The lopsidedness is a function of their being slower potential for health and education advance, or, in some cases (e.g. health in Russia) a stalling of progress. Second, there are Southern African countries who have been hard hit by HIV/AIDS: Botswana, for example, would surely have been a star of the "virtuous" category, with a plausible institutional story to explain this (see Acemoglu et al, 2003) if it weren't for the awful retrogression in mortality induced by this epidemic

"Vicious" processes.

These countries did poorly on both growth and the education and health components of human development. They are strikingly dominated by countries in Sub-Saharan Africa, though there is also Argentina (who periodically produce the best footballer in the world, but win the World Cup less often) and Lebanon (caught in the maelstrom of Middle East conflict).

So what can be said about Sub-Saharan Africa from the perspective of this essay? This requires a much more extensive discussion than is feasible here, but I think the prism of distorted and unstable social contracts can be a useful organizing principle.

Let's start with the extreme cases. How do states suffering histories of violent internal conflict—that often also fall into the category of so-called "failed states"—fit within this story? They have been a major feature of the past 20 years or so, and represent the most extreme forms of failure in human development. One of the trends in the literature of the past decade of so has been to view conflicts as driven by the possibility of capturing lootable resources—that provide both the incentive to fight and the resources to finance conflict. This is sometimes contrasted with the origins of conflict in historically-shaped grievances, that characteristically fall along lines of identity- or class-based groups, even if in practice both types of influence are present in the most cases of conflict.[10]

From the perspective of this essay, both the greed and grievance account is not the central issue. It is rather that conflict-ridden and failed states represent extremes of failure in a sustainable social contract between different elite and social groups. This is often associated with extreme forms of predatory behaviour by elites and with the mobilization of identity-based groups along lines of historical grievances. The real issue concerns understanding how a political equilibrium can occur that supports distributional allocations and conflict-management mechanisms that manage underlying conflicts without this spilling over into group-based violence

The important point here is see civil wars not as features of aberrant countries but as a consequence of a more general phenomenon of the nature of state formation in much of Africa. Take the approach of Azam (2001, 2005), who argues that many African states have rent-sharing between competing groups—often identity-based, ethnic groups—as the central mechanism for maintaining a peaceful equilibrium. Historically rents were often extracted from the rural sector,

[10] There's a big literature here: Collier and Hoeffler (1998) argue the greed story, though their work has also been extensively criticized.

from black markets, or corruption in major projects, whether in mining or infrastructure. But the stability of such a systemic division of the spoils depends on whether the group in power, often embodied in the person of the President, is able to credibly commit to sustain the rent-sharing amongst groups. This sharing includes direct sharing of private rents, in the form of positions or other advantages, for the elites from different ethnic group, and a judicious redistribution of development projects to different regions (albeit often layered with corruption). In Côte d'Ivoire, President Houphouët Boigny was reportedly a master at using the state for such managed redistribution of rents, and had the credibility deliver on this. This laid the basis for some years of steady expansion in growth and other dimensions of human development, albeit at slow pace, owing to the fundamentally rent-extracting nature of the economic and political system. Where leaders used their command over the state to limit rent-sharing to their own groups—as with Milton Obote and Idi Amin in Uganda—this stoked the fires of future violence. However, even functioning rent-sharing systems can be fragile, especially when there are transitions of power, through death or election. In this account the transition from decades of political stability to conflict in Côte d'Ivoire makes sense: with the death of Houphouët Boigny the credibility of the state also went, and fights over rents spilled over into violence.

Underlying this account is the nature of many, perhaps most, African states. The core idea (see van de Walle, 2001) is what has become known as the neopatrimonial character of the state: this involves a blend of patrimonialism, in the sense of deeply clientelistic practices, often embodied in the personalized leadership of groups, with rational-bureaucratic elements. However, unlike forms of clientelism in Latin America (or, for that matter, in the machine politics of US cities), the state elites have a substantial degree of autonomy in extracting and sharing resources: the problem is the lack of deep embeddedness in societal actors. This has further reacted nastily with the long-term macroeconomic problems and associated reform efforts to undercut state capacity: the civil services has always been a favourite vehicle for the exercise of patronage, but this combined with failures in revenue collection (itself linked to opportunities for private rent extraction) to produce a fiscal crisis, the collapsing public sector wages of the 1990s, and a further debilitation of state capacity.

A final ingredient of the malaise is relatively weak indigenous business capacity. There is an abundance of small-scale business dynamism, but (outside South Africa) much more limited development of organized African business—indeed a deficit of oligarchic capitalism! This reflected the depredations of colonial history, the fact that more successful business groups were often themselves of ethnic origins outside the political core (e.g. Indian, or Lebanese) and the more recent post-independence history, in which rent-extraction and failures in public good provision were the norm, and credible commitment to capitalist expansion short in supply. Periods in which ideologies of African Socialism essentially overlaid rent-extracting and sharing systems also didn't help.

In sum, where social contracts were functional to political stability they were embedded in redistribution across groups, and especially within elites. Moreover, they can be fragile, and can tip over into conflict. Credible commitment for capitalist expansion is difficult under these conditions. Or it is confined to resource-extracting enclaves, that are often spatially isolated from the bulk of the nation—in contrast even to past African experience, in for example, the Zambian copper towns (Ferguson, 2006). Weak state capacity is often endogenous to the neopatrimonial functioning of the state, adding a further twist to vicious cycles. Long-term effects of democratization may turn this around, but the path remains unclear. However, absent construction of more effective social contracts for capitalism and social provisioning "reform" efforts are likely to be disappointing at best, and distorted at worst.

Transitions

How does a society transition to a better or worse state, or, in the language of this essay, to social contracts with capitalists and social groups that are more favourable to large, equitable advances in human development? This is a massive question, and I'll make just a few comments at this stage.

As a general proposition, shifts in the social contract will only become feasible when underpinned by changes in some of the conditioning factors—those listed in the first box of Figure 3: economic structures, the nature and salience of social groups, political processes and belief systems. This may sound either banal or deterministic, but I think it does help as a way into exploring particular cases. Here are three examples.

First, late 19th Century United States feature the rise of the "robber barons", dynamic oligarchs who made massive fortunes, from the railroads, oil and other means, and created monopolistic "trusts". These were eventually broken. But this involved a happy coalition of populist political movements and an active executive branch of government (notably President Teddy Roosevelt) with a mandate for change that laid the basis for the anti-trust movement (Robinson, 2009). It also involved a functioning judiciary—with key decisions being made by the Supreme Court. A combination of political processes, social movements and belief systems on the nature of capitalism, were relevant here.

Second, take the decisions over liberalization and privatization in Mexico. The debt crisis of 1982 represented the combination of eventual decline in dynamism of Mexico's capitalism—in a state and oligarchic blend with insufficient incentives for innovation—and emergent populist pressures, temporarily resolved by increased borrowing. The interesting question is why an oligarchic business community, traditionally wedded to protecting the club, agreed to support the radical opening associated with joining of NAFTA. The political economy story was that such opening constituted a commitment device—badly needed in the wake of statist interest groups and the 1982 banking expropriations: opening to external competition was the quid pro quo for the substantially increased guarantees against expropriation by the state (Tornell and Esquivel, 1995). Unfortunately the privatizations of the parts of the state not open to external competition created an array of monopolies, and indeed a number of billionaires, including Carlos Slim, in 2010 the world's richest man. Change did occur, but the new equilibrium is far from optimal: parts are embedded in a restructured social contract with business in which new oligarchs have substantial power, benefiting from, and indeed with an interest in, the continued regulatory and judicial "weakness" of the state. Meanwhile, the deepening of democracy has led to shifts in the social contract with social groups, but this has often gone into inefficient and clientelistic forms of social programmes (Levy and Walton, 2008).

Third, Spain in the 20th Century experienced both the devastating civil war of the 1930s and an economically, socially and political successful transition to democracy, the rule of law and consolidated social rights. The civil war was a consequence of a highly polarized society, failures in earlier modernization and, in the end, victory for established elites in an essentially zero-sum fight of distribution of wealth. The later transition was in part based on a modernization and opening that started around 1959 (in the wake of a macroeconomic crisis) and led to sustained growth, reduced inter-regional inequality, and created new urban-based working class and professional interests. After Franco's death, a swift and successful transition to democracy was engineered. But an important part of the deal was the restructuring of the social contract, with a major expansion in social provisioning. Also important was the prospect of entering the Economic Union, that provided a powerful spur to opening, with the associated competition transforming important parts of Spanish capitalist structures. (Boix, 2008, World Bank, 2005, pps 105-106, Rajan and Zingales, 2003.)

5 Concluding thoughts on policy

This essay has argued for an approach to interpreting economic and social change in terms of how social and economic institutions function. The particular focus has been on the nature of capitalism and the functioning of the state: these are central drivers of success or failure in human development, and are in turn shaped by the underlying social contract, and historically formed capacities in the business and state sectors. So what does imply for policy design? At one level, this approach takes us to a critique of two common approaches to policy design: the technocratic fix, that assumes a well-functioning state and regulatory system; and the transplanted institutional solution. Both can be irrelevant or are likely to be distorted by the prevailing conditions of political and social forces and state capacity and functioning.

However this does not mean that nothing can be done. It rather pushes the policy design question into two complementary domains. First, what policy design is aligned with the existing political equilibrium? Second, what can be done that could shift the overall political equilibrium to one that is more favourable to equitable development, in the sense of fostering Schumpeterian rent-creation, dynamic, inclusive, well-regulated capitalism and good enough states in terms of service provision, innovation and accountability?

Occasionally there will be genuine critical junctures, in which societies go through major transitions, whether due to external shocks or the cumulative effect of internal processes of social and political changes. Transitions to democracy and resolutions of conflicts are often emblematic of the latter: South Africa in the 1990s, Brazil in the 1980s, Mexico in the late

1990s, Indonesia after 1966 and again after 1998, Nepal after the accord with the Maoists and removal of the monarchy, Guatemala after the Peace Accords. Less dramatic shifts can occur through normal electoral transitions, such as the election of President Evo Morales in Bolivia, with an explicit mandate in favour of indigenous interests, and the election of the coalition around the Congress party in India in 2004 (and 2009), with a mandate for a shift to greater social provisioning.

While such points of transition present opportunities, policymaking in times of transition can be complex, because vested interest can re-group, new actors can move into established positions of advantage, and organizational responses can be unpredictable. The very mixed results of Big Bang reforms in countries in transition from communism in the Soviet bloc, illustrate the hazards of radical policy shifts in transitional institutional environments.

In practice policy innovations may fall in interesting grey areas: sufficiently aligned with prevailing institutions to be workable, but also with opportunities to effect gradual changes that can, offer time, effect changes in how capitalism or the state functions. Let's take two examples, one relating to capitalism and one to social provisioning.

First, consider the India deregulation. There was an inflection point around the 1991 macroeconomic crisis, that is often characterized as the moment of opening. But the more interesting story is longer term. India has a very long tradition of entrepreneurial activity, with well-established business families and networks. Many business families supported the independence movement, and were politically aligned with the post-independence governments. During the License Raj period, the state shifted to a pattern of extreme over-regulation: this restricted activities of the corporate activities, but without generally threatening the overall contract between the state and domestic business interests. A deregulation process then started in the 1980s—what has been characterized as a shift to a "pro-business" orientation (Kohli, 2006; Rodrik and Subramanian, 2004) in part at least as a strategy of accelerating growth. The 1990s liberalisation involved both removing restrictions on corporate activity and a steady opening to foreign competition—in effect reducing regulatory burdens in return for pressures on efficiency. It is also interesting that there has been no reversal: in the critical initial period there was some contingency to this, since the secular left was more concerned about the rise of Hindu

Nationalist movement than market opening. The evidence on entry into new sectors, on general churning, on capitalists emerging from different groups, and on profit determination supports the view that this phase of capitalism has been dynamic, despite the continued importance of both publicly owned companies and business groups in the sector.[11] By the late 1990s and 2000s there is effectively no questioning in the mainstream of general principles of the reform, though there is intense (and important) debate on complementary social action, and also over specific aspects of corporate governance and state-business relations.

Second, take the introduction of conditional cash transfers in Mexico under the PROGRESA (now *Oportunidades*) programme. Social programmes had historically been embedded in a clientelistic political system. A political opportunity for change was created by a combination of the assassination of an anointed presidential candidate and the general revulsion against perceived corruption under President Salinas. Economic opportunity was created by the necessity to undertake major fiscal adjustment in the wake of the 1984/85 Tequila crisis, that in particular meant that the untargeted food subsides had become unsustainable. A group of technocrats, backed by the incoming President Zedillo, then designed and introduced a means-tested cash transfer, conditional on children attending school and mothers and children attending health clinics.[12] This was centrally managed within the Federal system, using central capacities for the beneficiary selection and financial management, combined with the good-enough local teaching service for verification. External evaluation was sought to reduce the probability of the programme become seen as a product of one political party—the PRI indeed lost the election in 2000 after the 70 years in power, but the incoming government, took over, re-named and expanded the programme.

There is much more political and policy texture to these stories. The purpose here is only to illustrate a general point: even outside major critical junctures there is scope for policy design that can have a significant influence on the dynamics of human development. But such policy design has to be sufficiently aligned with the domestic social contract and local capacities to be feasible. Some policy shifts can become part of a process that shifts not only specific dynamics

[11] Panagariya (2008); Damodaran(2008); Alfaro and Chari (2009).
[12] See Levy (2007); Levy was the key technical architect of PROGRESA, then from his (powerful) position as vice minister in the Finance ministry.

of the level and distribution of wealth creation and opportunities for social development, but can become lead to shifts in the social contract itself. The India policy moves were consistent with a long-term shift toward a more open form of capitalism dependent more on dynamic rent-creation and sharing than fights over existing monopoly rents. This is incomplete, and there are genuine risks that oligarchic forms of capitalism will undercut long-run dynamics, but it clearly changed the state-business relationship in this period.[13] In Mexico the substitution of the targeted conditional cash transfer for both broad-based tortilla subsidies and (to some extent) clientelistic local public works programmes, led to changes in the form of the contract between the state and social groups outside the formal sector. This is part of a complex ongoing process, closely linked to the continued imperfections of democratic functioning. But it was a step nevertheless.

These examples are of specific policy design changes. There are also a range of measures that are more directly related to shifting the *systemic* functioning of capitalism and the state. Introduction of competition and regulatory authorities and reform of financial regulation are good examples of the former. Such regulatory attempts are contested, can be subject to re-capture, or can lead to overbearing state action—as vividly illustrated by ongoing debates on financial re-regulation in the US and Europe in the wake of the 2008/09 financial crisis. Success or failure is likely to depend both on the underlying political equilibrium and design specifics. In similar spirit, action to increase information on state functioning is a good example, especially where these have been embodied in right to information laws, that have spread substantially around the world in rich and developing countries alike (including Mexico and India)

There has been major progress in many aspects of human development over the past few decades. But the world remains extraordinarily unequal. Future dynamics will not depend on specific policy tricks, but on the overall functioning of the two most important drivers of change, capitalism and the state. How this works is a question of institutional functioning that needs to be understood in terms of the underlying social contract within societies. This social contract evolves, especially in response to the agency of domestic groups. But policy design that is abstracted from an understanding of such institutional processes is likely to be irrelevant.

[13] See Rajan (2008) for a brief statement of the threat of oligarchic capitalism; also Walton (2009) for an overview.

Appendix: Categorization of countries by pattern of human development growth

Appendix Table 1 presents a simple categorization of countries in relation to whether their pace of change was above or below the median for the human development (health and education) and growth in income per capita. Countries above the median for both categories were characterized as being in a "virtuous" process; those below the median on human development and growth as being in a "vicious" process; the remainder were lopsided with respect to either human development (above median human development, below median growth) or growth (vice versa).

Appendix Table 1. Patterns of country experience, 1970-2007

"Virtuous"	**"Vicious"**
Bangladesh	Argentina
Brazil	Burundi
Cambodia	Cameroon
Chile	Central African Republic
China	Congo
Colombia	Congo (Democratic Republic of the)
Costa Rica	Côte d'Ivoire
Dominican Republic	Ethiopia
Egypt	Fiji
Honduras	Ghana
India	Guyana

Indonesia	Jamaica
Lao People's Democratic Republic	Kenya
Malaysia	Lebanon
Mauritius	Malawi
Mexico	Mali
Morocco	Niger
Nepal	Nigeria
Panama	Paraguay
Samoa	Rwanda
Thailand	Senegal
Tunisia	South Africa
Turkey	Tanzania (United Republic of)
Uruguay	Uganda
“HD-lopsided”	**“Growth lopsided”**
Algeria	Belize
Bahrain	Botswana
Benin	Bulgaria
Bolivia	Burkina Faso
El Salvador	Former Soviet Union

Guatemala	Hungary
Iran (Islamic Republic of)	Lesotho
Jordan	Mongolia
Liberia	Mozambique
Libyan Arab Jamahiriya	Poland
Madagascar	Romania
Nicaragua	Sudan
Peru	Swaziland
Philippines	Tonga
Togo	Trinidad and Tobago

Source: Human Development Report office.

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