A shanty, which fisher folks built by hand, stands proud in the middle of Laguna de Bay, dwarfing the skyscrapers behind it.

Photo by Erwin Tiamson

This photo was taken on February 24, 2011 in Barangay San Vicente, Angono, Province of Rizal.
Human agency has not had a prominent seat in the table of development ideas of the post-World War II (WWII) era. The emergence of the role of institutions in the development landscape and of the all-important question of how to induce institutional change has opened the door for human agency in the first decade of the 21st century. In this chapter, we summarize the evolution of development thinking in the second half of the 20th century and suggest that the human agency is a logical corollary. We argue that one form that human agency takes in institutional change is developmental entrepreneurship acting through the instrumentality of collective action.

Mechanical engineering models of development, which dominated the post-WWII era, made the capital and financing gap the compelling issue of development. In the process, they buried the role of institutions and human agency in the inert constants of its equations. The burial was made plausible with the deployment of some fundamental simplifying assumptions: (a) the unlimited supply of labor, which rendered the supplier of labor services a pure wage-taker; and (b) the benevolent central planner, which banished diversity and political conflict from the development discourse. The pivotal role of development agencies was highlighted by the belief in pure altruism among development agencies. These meant that resources made available are always the right ones, and the recipient always deployed them to maximize public welfare. As events and development outcomes would reveal, institutions and human agency cannot be so cavalierly treated in the long-run trajectory. The so-called parameters do not stay put, and the predicted positive growth vanishes or reverses in sign. Governments are seldom benevolent or competent, and often privilege private interests over the public interest. Capital made available by aid or loans only gets frittered away when the extant institutions are not right and wobble under political pressure. Non-altruism and/or hubris among aid agencies push capital of the wrong kind and costly equipment rusts in the warehouses.

The “Policy First” paradigm dominated the last quarter of the 20th century. Development failures, which were manifested by periodic crises, meant the package of policies that were largely anti-market was wrong and must hence be made to conform to a set of policies that appeared to
be effective in delivering stability and growth in some countries. This set of policies came to be called the *Washington Consensus*. But how do you induce the dismantling of wrong policies, which are nonetheless products of political bargaining and negotiation—in other words, political settlements among internal players? The answer was pressure from the outside, embodied in the conditionalities attached to aid. A number of problems stood in the way. One was the “Samaritan’s Dilemma” where donees find it advantageous to evade difficult reforms in favor of pro-forma ones, which however manage to continue the aid flow. A law may be passed without the requisite enforcement mechanism. More importantly, even when some conditioned policy reforms are implemented, the requisite regulatory mechanism may not be in place. For example, a state monopoly may be privatized by virtue of the World Bank condition, but the resulting private monopoly’s abuse—its market power in the absence of adequate regulation—reduces or erases the welfare gain. Reforms that are not accompanied by changes in the beliefs and perceptions of the domestic players are considered temporary and reversible, so that investments do not confirm the reform. New market ventures that are not guaranteed from expropriation or policy reversals will not be entered. If third-party enforcement of contracts is weak, contracting will likely evolve towards the less productive spot contracts.

Policy reforms need to be hung on additional embedded scaffoldings to perform their magic. These scaffoldings, which we call *institutions*, are at the heart of the emerging development paradigm as the 21st century began. Good institutions and good economic performance appear to correlate strongly. But how does a polity acquire good institutions? Institutions can be viewed as carefully crafted *political settlements*, which result from bargaining among various interests and groups in society. They can subvert the public good. Indeed, in weak governance environments, they tend to be predatory. The ascendance of institutions in the development narrative puts human agency squarely at the center of the inquiry. Institutional change is an artifact of human agency. Institutional changes that enhance greater inclusiveness are public goods that seem to require a special trait. For lack of a better label, we call this *development entrepreneurship*. This chapter, distilling the lessons of the cases here documented, explores how development entrepreneurship may be engendered. In the following, we detail these ideas starting with the mechanistic thinking.

**Mechanistic Models in Developing Thinking**

The decades from 1950 to 1980 were dominated by a mechanistic view of development, one which relegated institutions and human agency
as background constants of the growth equation. The central idea was the capital gap.

**The Capital Gap View in Development Theory**

Mechanistic development models are economic-engineering formulae that deliver growth automatically once the identified gap is filled. The first was the capital gap (see, e.g., Fabella & Gunatilake, 2007; Thorbecke, 2000). The event that shaped the development thinking in the second half of the 20th century was no doubt the *Marshall Plan* that underpinned the post-WWII reconstruction of Western Europe. The Marshall Plan financed the massive physical infrastructure reconstruction of Europe, which laid the cornerstone of the “30 Glorious Years.” Postwar Europe had a massive financing gap (to be discussed further in succeeding paragraphs) for which the Marshall Plan was the perfect response. From originally financing imports and balance-of-payments (BOP) support, it embraced project (infrastructure) aid as the dominant delivery modality (Tarp, 2006).

The postwar era also saw many former colonies attaining political independence from their colonial masters. They were at once destitute, in great haste, and facing huge capital gaps. They were increasingly being reminded of how Soviet Russia had moved rapidly from the backwaters to—arguably for many and decisively for some—the leading edge of development. It was argued that replicating mini-Marshall Plans in the Third World would produce an anti-communist phalanx. These were the formative events that shaped subsequent aid attitude in the West. These events, however, had support from, and in turn, supported prevailing developmental paradigms.

The Marshall Plan received intellectual support from Rosenstein-Rodan’s (1943; 1961) *Big Push* idea. Rosenstein-Rodan argued that indivisibilities and market failures abound in Third World economies and give rise to increasing returns and external economies. To leapfrog these, one needed very large outlays of capital. Since this will not be provided by the market, it is imperative that the state step in and provide for the “social overhead capital.” But the modicum requisite investment may be so large that it cannot be afforded by the economy, especially one just coming out of the war. Thus, to finance the capital requirement of Eastern and South-Eastern Europe when the war ended, Rosenstein-Rodan proposed in 1943 the *Eastern European Industrial Trust.*

Corroborations and articulations of the Rosenstein-Rodan idea proliferated. To Ragnar Nurkse (1953), the clarion call was for a “balanced growth” or “a frontal attack—a wave of capital investments in a number of different industries.” For Leibenstein (1957), it was the “critical minimum
effort” idea. The concept of the low-level equilibrium trap, which motivated the “critical minimum effort” and the “critical ground speed” viewpoints, was suggested by Nelson (1956). Hirschman (1958) proposed the idea of “backward and forward linkages.” W.W. Rostow (1959) hit on the stages of economic growth emphasizing the “take-off” stage “when the scale of productive economic activity reaches a critical level and produces changes, which lead to massive and progressive structural transformation...” Rostow’s influence was to shape US foreign policy toward aiding least-developed countries (LDCs) attain take-off, so as to form a bulwark against the Soviet sphere expansion. The Great Spurt was Gerschenkron’s (1962) characterization of the drive toward high growth in large manufacturing and the relative neglect of agriculture. All had one thing in common: they pointed to “capital deficit” as the central bottleneck.

While this paradigm receded to the background in the waning decades of the 20th century, the associated economic ideas would resurface time and again. The modern reincarnation of the Big Push idea is perhaps Jeffrey Sach’s much-discussed and criticized book, The End of Poverty (2005), to end poverty in sub-Saharan Africa via the ramping up of aid to committed levels.

Financing Gap in Growth Theory

A parallel development, this time in the Theory of Economic Growth, tried to understand the experience of Western economies and especially the growth of Soviet Russia. Evsey Domar (1946) proposed a framework that showed the growth of gross domestic product (GDP) as a fixed proportion of the share of investment in GDP. This came to be known as the Harrod-Domar Model. The fixed-proportion technology employed the idea of “surplus labor” with zero marginal product. In the aftermath of WWII, the surplus labor came from decommissioned military personnel. It also echoed the current understanding of the Soviet economic strides (Domar was, after all, a Russian émigré).

The Harrod-Domar Model had one magical aspect that the previous genre lacked—it gave the profession an idea of the financing gap. In very simple terms, the financing gap is the difference in the rate of investment that a country can finance by itself and the rate of investment that it needs to attain its desired growth rate. This further strengthened the claim of the financing gap as a central concept in the praxis of growth promotion and aid level determination.

A version of the Harrod-Domar Model customized for Third World countries was introduced by Arthur Lewis (1954). The starting point was the existence of “rural surplus labor” that made capital to be the only
binding constraint, allowing fixed-proportion technology. Again, the Soviet Russian economy, as in Rostow, was the archetypal explicandum. “Capital accumulation is economic development” may well be the principal mantra of that development era. The Lewis dualistic labor-surplus economy was formalized by Ranis and Fei (1964) in their dualistic model that came to be known as the *Ranis-Fei-Lewis Model*.

It is no surprise that aid-allocating agencies find comfort in capital deficit models of growth (Ranaweera, 2003). In this reckoning, aid agencies hold the key to growth as they hold the wherewithal to close the financing gap.

By the early 1970s, it was clear that while economic growth was becoming a sustained reality in East Asia, it was not the rule. Another widespread observation was that growth was not readily translating into poverty reduction; the benefits of growth were not being shared. Not enough of the so-called trickle-down effect was happening (Chenery, Ahluwalia, Bell, Dully, & Jolly, 1974). By current understanding (the *Kuznets Inverted U Hypothesis*), income distribution should first worsen before it improves in the process of growth. The consensus of the 1970s, therefore, was that aid and development agencies redirect aid towards more income equality and inclusive growth. The departure was, however, more nuanced rather than substantive.

**The Invisible Human Factor**

This mechanical engineering view had nothing at all to do with the people. Human actors were invisible, compressed into black boxes called “constants” or “parameters” (as in the *incremental capital-output ratio*). Their freedom and power to decide are of no consequence. How about the governments of nations? The underlying assumption was that the state was a benevolent central planner, another product of the 1950s (Samuelson, 1954). Without fail, this state would apply any additional capital to the best possible use. Moreover, labor was rendered completely passive by its unlimited abundance (as in the Ranis-Fei labor surplus economy). Economic agents, both kings and peasants, did not matter through this array of deft assumptions. This turned out to be very naïve, but at that time, it was not yet known. As it became revealed later, growth had, in fact, little to do with resource or capital constraint but everything to do with policies, institutions, governance, and even cultural factors—all emanations and artifacts of human actors. These issues still lay outside the purview of the orthodox economics of that period (Landes, 1998). These ideas, together with the corroborating Prebisch-Singer export pessimism (Singer, 1965), shaped policy certainties that spawned the import substitution era of the 1950s.
The Policy Deficit View: Intimations of Human Agency

The 1970s saw unprecedented turmoil in the world oil market. The oil-exporting countries jacked up oil prices by manipulating supply and amassed huge petrodollar revenues, which it then tried to recycle through the large banks. The LDCs facing oil import-driven trade deficits saw a window of opportunity for closing its financing gaps by foreign borrowing at very low—sometimes negative real—interest rates. These created unsustainable BOP and fiscal deficits when the world interest rate started to shoot upwards. These triggered the crisis decade of the 1980s, marked by severe macroeconomic instability.

Stabilization programs now hogged the development thinking. The structural adjustment lending became the logical adjunct of stabilization programs following a BOP or other crises. The occurrence themselves of BOP and other unsustainable imbalances suggested that some structural bottlenecks are to blame. The phalanx of economic policies was out of synchrony with economic realities and needed to be corrected if the imbalances were to be prevented from recurring. There was, in other words, a policy gap. The policy prescriptions eventually crystallized into a roadmap known as the Washington Consensus. It was recognition that domestic political settlements were out-of-tune with economic realities, as evidenced by the crises. Domestic forces by themselves cannot change these settlements, which can be modeled as stable equilibria of interest group games. But outside forces can change the political game and its equilibrium. The belief was that changes in these political settlements can be induced by a promise of financial flow from the outside. If nothing else, it re-introduced the human factor into the discourse. Policies, after all, are artifacts of human agency.

The answer in the 1980s and 1990s was the Structural Adjustment Loans (SALs) of the World Bank and the conditionalities of the International Monetary Fund (IMF). They became the workhorse of policy conditionality or policy-based lending in the 1980s. They were designed to ease the way for reforms largely involving domestic market policies, e.g., liberalization, privatization and deregulation. The whole concept was to “push” or “buy” reforms (Radelet, 2005; Easterly, 2003). It made good sense from the air at that time.

The performance record of the conditionality approach to policy reform, however, fell very short of expectations. This called for a re-examination of the aid delivery systems (Easterly, 2001; 2003; OECD DAC, 2005).

Not only was conditionality under question; the effectiveness of aid, in general, came under renewed scrutiny. New empirical results by Boone (1994;
1996) and White (1992) seemed to favor the null hypothesis of “no effect of aid on growth” over the judgment of just inconclusive evidence of the 1980s (e.g., Mosley, Hudson, & Horrell, 1987; Michalopoulos & Sukhatme, 1989). Finally, the Burnside and Dollar (1997; 2000) result pointing toward aid by itself having a negative effect on economic performance and being effective only if conditioned on a good macroeconomic and institutional environment, provided a window for how to improve outcomes. These gave renewed impetus to engendering good institutions that enhance aid effectiveness (see also Rajan & Subramanian, 2005; Easterly, Levine & Roodman, 2003).

The World Bank (1998) analysis of its own past conditionality-based projects concluded that “…donor financing with strong conditionality but without strong domestic leadership and political support has generally failed to produce lasting change.”

**Institutional Gaps**

Coincident with the growing disenchantment with conditionality was the emergence of a development paradigm that put “institutions” and “rule of law” at the center stage of development thinking (Bardhan, 1989; North, 1990; Keefer & Shirley, 2000). The view sprung from the now-widely accepted empirical observation that the development of Western Europe closely dovetailed the emergence of market-enhancing institutions, whether state-based or market-engendered, that made exchange, long-distance trade, and time-mediated exchange less risky and more predictable (North & Weingast, 1989; North & Thomas, 1973). These institutions provided protection for property rights and enforcement of contracts. For examples of such, there are the Maghribi and the Bank of England (Greif, 1989; North & Thomas, 1973).

It was a short leap from here to the observation that development failures are close correlates of institutional failures. Sensible economic policies, such as deregulation or privatization, cannot engender enough new private investments where there is an overhang of considerable regulatory uncertainty. The empirical support from cross-country studies came fast and furious with the availability of governance quality indices (e.g., Kaufman-Kraay, Freedom House, and The World Bank Institute) that proved very statistically robust. The “institutions matter” view reached its height in the “deep determinants” debate where the consensus seemed to be “policies don’t matter as much as institutions” (Rodrik, 1999; Rodrik, Subramanian, & Trebbi, 2002; Easterly & Levine, 2003; Knack & Keefer, 1997; La Porta, Lopez-de-Silanes, Shleifer & Vishny, R., 1999). This, as we shall see, would generate new development mantras, institutional deficit and governance matters, which would guide aid-giving and development policy in the new century. Although the cross-country
econometric results have well-known weaknesses—especially when applied to policy-making in individual countries—taken as a whole, they shaped conviction in a new and meaningful direction. More importantly, individual country case studies and experiences tended to be corroborative.

The still-unfolding economic miracle called the People’s Republic of China (PRC) is prima facie evidence of the strong link between rapid growth and growth-enhancing institutions. PRC, starting in the 1980s, experienced a massive transformation in institutions: the massive retreat from purely state to market provision of goods and services, the use of prices to allocate goods and capital, the embrace of direct foreign investment, the determination to unlock the potential of the global export market, and the celebration of private wealth accumulation, among others. These institutions induced massive investments (investment rate is around 35 percent per year), which engineered a transformation never before witnessed in history. Already about 400 million people have crossed the poverty line. The PRC is now the second-biggest economy in the world with a trillion dollars in foreign exchange (forex) reserve. It is pulling along the growth of the global economy. The story of post-Mao PRC is the story of good institutions enabling human actors to engender rapid and inclusive growth. Vietnam’s emergence also confirms these new beliefs. These two cases are particularly pronounced because the institutional changes were brought about by internal forces rather than by external inducements, thus confirming the 2005 Paris Declaration's principle of local ownership.

There is hardly any question now about the importance of institutions in economic growth. But that knowledge is less compelling if institutions are fixed and static entities not subject to human influence. Geography is also important to economic outcomes, but we cannot change geography. We also know that institutions change, but the process of change may itself be just random. The emerging consensus is that institutional change can be induced and guided. But how?

**Institutions as Artifacts of Human Agency**

To address the question of how institutional change comes about, one must first address the question, “What are institutions?” Parks and Cole (2010), following Khan (2009), adopt the constructive label “political settlements” to describe the wherewithal of institutions:

Institutions are... the product of ongoing conflict, negotiation, and compromise among powerful groups, with the ruling coalition shaping and controlling this process. In most cases, power relations are fluid and dynamic, and political settlements are constantly
adapting and subject to renegotiation and contestation. As a result, political settlements should not be interpreted as one-time events, but rather as rolling agreements between powerful actors.

In other words, institutions are no-conflict zones made possible and enduring by the threat of costly conflicts among contending groups. Mutually assured destruction made the institution of limited confrontation the lasting arena of contestation during the Cold War. Institutions are by analogous description the stable equilibria of the coalitional games played by various groups in pursuit of their own interests in society (Greif & Laitin, 2004; North, Wallis, & Weingast, 2009). A comprehensive review of how these political settlements are reached, maintained, and undermined is given by Parks and Cole (2010). The older development orthodoxies did not worry about the messy tug-of-war between contending parties in developing countries. Tried-and-tested formulae can be imported from the developed world by governments that are monolithic, conflict free, and benevolent.

The problem is that in the real world of politics and vested interests, political settlements are sensitive to bargaining power lodged among the elites, and thus, can be used to serve their interests. They can, therefore, be non-inclusive and even predatory. Beneficiaries will fight tooth and nail to preserve their privileges. How does a status quo that benefits a few get replaced by another which benefits the many? In other words, how does an old iniquitous political settlement get undermined? This is the development challenge of our time. Anyone who cracks the code will have an inside track on the Nobel Prize in Economics.

Aid and development agencies are naturally the most ardent consumers of these ideas. Aid agencies are themselves repositories of first-hand experiences of trying to introduce reforms. The meager state of knowledge on institutional change based on aid agency experience is summarized by Shirley (2008):

(i) Most institutional change takes much longer to germinate and render permanent than the timeframe of aid projects;

(ii) Sustained institutional change requires changes in norms and beliefs, which outsiders, even with their superior resources, cannot easily influence;

(iii) Among instances of successful institutional shifts, the role of insiders and local agents proved all important, and their views may not always jibe with the best practice championed by the donors;

(iv) Absent complementary institutional scaffoldings, aid may just
create perverse incentives for, if not prop up, the very opponents of reform.

The toughest condition seems to us to be second on change in beliefs and norms that underlie sustainability. Time is of the essence here and quick fixes are the potential pitfalls. These lessons serve as the caveats to political advocacy, especially for aid agencies seeking to force open political settlements by superior inducements. One track is via conditionality. Since we have already observed the poor record of the conditionality approach to policy change, we dwell now a little on why.

**Conditionality as Institution Changer**

The conditionality approach is an externally induced modality toward institutional change. Azam and Laffont (2003) showed that given donee choice in an aid-contracting game, unconditioned aid results in the enrichment of the elite and the exclusion of the poor in the recipient country. By contrast, the attachment of conditions for aid biases the political process in favor of the poor. But theory can be very misleading here. It is assumed that the donor can enforce the contract (punish the donee for non-compliance), which is seldom true. As a result, the conditionality approach to institutional change is also subject to the Samaritan’s dilemma. The Samaritan’s dilemma (Buchanan, 1977) describes the situation where the donee deliberately chooses to remain poor by avoiding acts that lift him out of his or her poverty, since continued poverty induces continued aid flow from the donor. The donors (if indeed they are Samaritans) are only too eager to interpret some (however pro forma) performance as adequate to warrant continuation of the aid relationship. To put it differently, the donee, equipped with fishing gear, refuses to fish in order to induce continued donation of fish. Thus, conditionality as institution changer has a poor record. But this has not stopped experimentation with externality-induced changes.

Conditional aid relations are contractual relations, and real contracts can cover only some—but not all—the required deliverables. This is known as incomplete contracting (Williamson, 1985). There is a lot of room for reneging, especially where the deliverables are not easily observable. The ruling elite of the recipient country signs that contract, receives aid, but cherry picks and delivers only the least costly and least binding items, leaving intact the more costly and binding constraints. The former are what Shirley (2008) calls “pro forma reforms,” which are often associated with the Samaritan’s dilemma. In Shirley’s words:

Ruling elites often prefer pro forma changes so they can obtain funds without politically costly changes in deep-seated
constitutional rules, norms and beliefs—the Samaritan’s dilemma... conditionality will be met by passing laws without mechanisms for their enforcement; creating agencies without adequate staffing, budget or mandate... etc.

**Conditionality Tournaments**

Are there ways out of the Samaritan’s dilemma? Running the aid game as a tournament is the new and ongoing experiment to improving aid effectiveness. There is a limited aid fund to be disbursed to an unspecified number of countries. Reform hurdles are set and agreed to by a country applying for a share in this fund. The diverse domestic human agents and groups within its borders bargain among themselves to clear the hurdles in view of the promised future aid flow. Those who clear the committed hurdles receive a share; those that don’t will have to try harder next time. This is the concept behind the *Millennium Challenge Account* of the United States.\(^1\) In theory, while this appears to solve the problems of contemporaneous or ex-ante conditionality, it still has peculiar problems. Those who are able to clear the hurdle are usually also the least needy (they can afford the financing and political cost of reform on their own). In fact, these do not need the aid flow because private loan providers know their capacity, and thus, flock to their doorstep. The result is that aid flows inversely to need.

Genuine desire to clear the reform hurdles on the part of the donee can also coexist with a real inability to finance the cost of transit to a new regime. The donor may not be there by design to lend a hand. And when this rule is relaxed (as when financing for reform is made available before the hurdles are cleared), the Samaritan’s dilemma again rears its head. Likewise, since the hurdles are many and diverse, and cherry picking is possible, even poor performance relative to hurdles may be interpreted as adequate, due again to the Samaritan’s dilemma. Effectiveness will be sacrificed. However, the main drawback of conditionality as an institution changer is that it lacks local ownership.

**Institutional Change and Indigenous Collective Action**

Why do some polities succeed in providing institutions that speed up economic growth while others don’t? One pathway that has attracted intense contemporary curiosity and interest is the polity’s capacity for collective

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\(^1\) The Millennium Challenge Account was created by the U.S. Congress in January 2004 to promote good governance, country ownership, and results in the country recipients. Read more at http://www.mcc.gov/.
action (see, e.g., Keefer, 2010). Collective action occurs when members of the same community work together to attain a collective goal that benefits all. This is not so easy, since individual agents would rather get a free ride on others’ contributions to a public project. This insight was introduced by Mancur Olson (1965) in that seminal work *The Logic of Collective Action*. A collective goal may be a physical asset (such as an expressway) that serves everyone, or a policy change that makes commerce easier and cheaper for all. Collective action capacity describes how well and how readily members of the same community work together to meet some collective action challenges, e.g., providing a footbridge or a *ronda* (night watchmen) in crime-ridden communities, or providing and enforcing a cooperative rule of behavior or a conflict resolution agency. A strong collective action capacity means that the community can mount ambitious scale-economic projects at a lower cost. A weak one means that only inconsequential projects get undertaken and completed. Institutional change towards more inclusive outcomes is a collective action challenge.

Again, the PRC is a good example of an immensely strong collective action capacity (evidenced by the building of the iconic Three Gorges Dam). The Philippines is an example of a state with weak collective action capacity (iconic examples are the San Roque Multi-Purpose Dam, whose irrigation segment—with the capacity to irrigate up to 70,000 hectares—has been lying idle for a decade, and the new state-of-the–art Ninoy Aquino International Airport [NAIA] Terminal 3, unused for six years after its completion in 2002). But a strong collective action capacity is a double-edged sword. It can be marshaled for weal or ill. Japan used its strong capacity for collective action to develop rapidly in the post-Meiji Revolution era (1868-1900). It also used this capacity for collective action in the 1930s and 1940s to wage aggressive and eventually self-destructive wars. Germany under Hitler rode the same remarkable capacity to rapid recovery in the 1930s and destruction in WWII.

But since collective action capacity is a double-edged sword, how does a polity shape collective action capacity to favor inclusive outcomes? Democracy has been suggested as one such facilitating institution. Rodrik (1999) has proposed that an *electoral democracy* is a *meta-institution* that spawns other good institutions. This has to do with facilitating accountability and the power of recall vested on the majority. But democracy understood as universal suffrage performs weakly at delivering public goods and economic growth (see, e.g., Barro and Sala-i-Martin, 1998; Keefer, 2011). Non-democracies have done better economically than democracies in East Asia, for one. There are many ways by which the accountability feature of majoritarian rule can be vitiated. One such is called the “tyranny of the minority.”
Mancur Olson (1965) introduced the differential difficulty for collective action among groups as an explanation for the tyranny of the minority: a cohesive minority can lord it over a diffuse majority in the policy market. Groups that command higher capacities should do better than others in a social contest, say, in the allocation of the budget or in electoral contests. This explains the persistence of institutions that fail to serve the welfare of the majority (the old PLDT monopoly and the NFA, among the cases documented in this volume) even as they erode that of the more numerous non-elites.

This has a resonance in the differential performance of countries in the development landscape. Countries with strong collective action capacity tend to provide better public infrastructure (because they can readily mobilize resources and bargain around obstacles), better legal protection, and more credible policy covenants for investment (say, for non-expropriation of private economic surpluses). Strong collective action capacity has surfaced in different guises in the literature: as “trust” in Fukuyama (1995) or as “social capital” in Coleman (1988) and Knack and Keefer (1997).

There is now a growing body of evidence to show that more primitive institutions, even in pre-democratic societies, may facilitate collective action and explain growth and growth-enhancing outcomes in those polities. Keefer (2011) shows evidence that long-lived institutionalized political parties, especially in non-democracies, do well in delivering public goods in poor countries while competitive elections do not. This helps to explain what is known as the “East Asian exceptionalism”: rapid growth without the scaffolding of formal electoral democracy. The key concept in this view is the collective action capacity of the polity. This type of political party facilitates the capacity of the memberships to discipline the leadership and redirects decisions towards greater inclusiveness. Their longevity also induces them to morph from what Olson called “roving bandits” into “stationary bandits” with a stake on future revenue flows.

**Some Essential Features of Collective Action Capacity**

For collective action capacity to decisively push inclusive growth, it must be endowed with two crucial features. It must be **strong** and it must be **properly directed**. Strong collective action capacity means that the decisions by the mandated center are not vetoed or undermined by other decision centers or attenuated by organs of enforcement. Some would call this “executive autonomy.” Some states, by accidents of their histories, already have strong inherited collective action capacities. The central authority already enjoys autonomy in resource mobilization, budget allocation, and project choice. This history may include dark episodes involving the complete purging of
potential and actual opposition (many countries used ideology to physically annihilate class enemies or send them into exile). The result is a period of strong collective capacity. Strength may also have been forged on the anvil of a long militaristic tradition. It may come from the terror in a police state.

Spells of collective action muscle, by themselves, may not deliver public benefits because they can just as likely be wrongly directed. As previously observed, collective capacity can cut both ways. North Korea is iconic for strong collective capacity with utter disdain for public welfare. It manages to wield absolute power despite consistently starving its own people. The PRC post-1949 enjoyed strong capacity for collective action (going to war in the Korean peninsula and almost winning showed that), but sputtered economically in pursuit of wrong goals under the Great Leap Forward of Mao Zedong. Cuba has a strong collective action capacity partly because all the potential oppositors are in exile in Florida. The training of such a collective action capacity for socialist goals has muted its benefits. The imperative in these countries is **correct direction**. Once the ship of state embraces the proper direction, it moves quickly. Witness the PRC after the ascendance and tutelage of Deng Xiaoping in 1978; witness Vietnam in the first decade of the 21st century. Provided that an about-face of their respective leaderships occurs, North Korea and Cuba can exhibit the genome of economic miracles for the next two decades. Getting collective action capacity to serve inclusive growth is a collective action challenge itself.

Other countries do not have the right histories to draw from for strong collective action capacity. Post-colonial democracies have the worst record. In many of these already largely fissured countries, democracy may have widened—rather than healed—ethnic, religious, and cultural divides. Witness the collapse of stable political settlements after Josip Bros Tito of Yugoslavia and after Saddam Hussein of Iraq.

When collective action capacity is weak as it is in many countries, the political settlements it is able to support are generally rent-extractive, a view inherent in North, Wallis, and Weingast’s (2009) idea of “limited access order.” For example, the incapacity of the Philippine state to enforce its sovereignty over Maguindanao Province led to an implicit political settlement, which gave the Ampatuan clan a monopoly of violence and rent-extraction powers over the area in return for opposing the Moro Islamic Liberation Front (MILF). The weak political center also buys the military’s loyalty by increasing its share in the state budget and looking away from how it is used. Thus, in these countries, the imperative is for collective action capacity to be at once strengthened and redirected. This is an even bigger collective action challenge. The case studies in this volume suggest the role of committed reform agents.
Development Entrepreneurship and Collective Action

The new institutions that undergird the modern economic miracle in PRC were fought for and ushered in by the pragmatists, led by Deng Xiaoping, after a long political struggle. These institutions redirected the strong collective action capacity in China from ideological goals towards the public good. The pragmatists were also quintessential insiders. Indeed, had outsiders held sway, the history of modern China would be very different. Likewise, the new institutions that supported the Japanese economic miracle in the post-Meiji period were engendered by the conscious embrace by the Japanese modernizers who won the right to redirect the nation by winning a civil war. In South Korea, the institutions that nurtured an export orientation, which proved inclusive, were set in place by President Park Chung Hee. These were true-blue insiders who identified the institutional and policy problems, found the alternatives, and used collective action capacity to undermine the prevailing political settlements, and install the solutions. These are iconic examples of “local ownership” championed by the 2005 Paris Declaration and affirmed by the New Institutional Economics.

The cases documented here confirm the importance of local ownership in the change process. This localness emerges first and foremost in the role played by indigenous actors navigating their local political jungles to engender locally conceived reforms. This we call development entrepreneurship, a mindset displayed by indigenous individuals or organizations that commit themselves to making their ambient socio-political institutions work for the greater social good. Development entrepreneurship entails the undertaking two genres of activities: (a) identifying the binding constraints on the one hand, and (b) reshaping the social and political circumstances on the other, which lead to the adoption of good institutions. What, in particular, do these consist of? From the case studies, this means the following series of actions:

1. Identifying the social problem: a binding constraint in the form of some law, agency, program, or practice within the status quo that exacts a large net cost on society at large, even as it often benefits only a privileged few;
2. Understanding how the binding constraint emerges as a political settlement among various self-seeking stakeholders;
3. Identifying or formulating an alternative to the binding constraint and carefully evidencing its superior potential benefits;
4. Bringing the alternative and its superior benefits to the consciousness of the leadership and/or of the public;
5. Identifying the vested interests expected to oppose its replacement.
because they benefit from the status quo; uncovering how financially or ideologically they are benefited;

(6) Identifying and building coalitions among the victims of the status quo and the potential friends and beneficiaries of reform, thus amplifying their political voice empowered with requisite intellectual armory and evidence-based arguments and studies;

(7) Identifying potential allies within the governmental decision structure and nurturing support with conviction by equipping them with requisite intellectual armory and evidence-based arguments and studies.

Items (1) to (3) constitute the “identifying the binding constraint” layer of development entrepreneurship; (4) to (7) constitute the “reshaping the social and political circumstances;” this corresponds to the economic entrepreneur seeking the buy-in of venture capitalists. This set of actions corresponds to the “introduction of new combinations” by a Schumpeterian entrepreneur. Development entrepreneurship thus embodies the two imperatives of an inclusiveness-leaning collective action capacity: the strengthening of the penalized majority’s collective capacity to extract institutional change, which when successful, effectively redirects the collective action capacity of the polity to serve the public good. Taken together, this is a gargantuan task undertaken normally only by very rare individuals or groups of individuals.

Development entrepreneurship may be displayed by a government actor, say, the president, a cabinet secretary, or a lawmaker (the president in the case of water privatization and telecoms deregulation), or it may be displayed by private persons or by organizations outside the government who pursue buy-ins by insiders (the case of aviation deregulation and the Residential Free Patent Law). It may be displayed by non-governmental organizations (NGOs) or civil society organizations (CSOs) (Schumpeter [1949] also included organizations among possible entrepreneurs). Whether by insiders or outsiders, the process of inducing change is long, messy, and unpredictable. As the failure cases show, nothing is guaranteed but aggravation. Rene Bañez, who led the ill-fated reform initiative in the BIR in 2001, still has to contend with lawsuits a decade after he was let go.

To observe that development entrepreneurship played crucial roles in the reform initiatives documented is not to say that development entrepreneurship is a sufficient—or even the most binding—ingredient in the change process. A development entrepreneur (DE) seems, however, to be a necessary—perhaps one among many—condition for the process to pull through. It is difficult to narrate of the cases without the doggedness displayed by specific groups of actors. While a crisis may occur or a favorable conjuncture may rear its head,
there is still a need for an actor or a group of actors to transform a problem into an opportunity—that is, to craft or divine the alternative, to get crucial decisionmakers to coalesce around this lodestone, and decide the best investment of their political capital. Banerjee and Duflo (2011) also narrate cases of exceptional individuals who made the difference in bringing about institutional changes that markedly improved people’s lives.

**The Emergence of Development Entrepreneurship**

Why the DE emerges is a difficult question to address. One problem is that good institutions are public goods and orthodox theory—whether going through Paul Samuelson or Mancur Olson—says these will be underprovided among selfish agents. For some, development entrepreneurship appears to require a non-selfish gene. It is increasingly fashionable to say that in each person’s make-up is a social gene that deeply cares for the social good of the community. Evidence for the need to belong to and to do well by one’s group has been mounting from evolutionary biology to brain studies (for a comprehensive review, see e.g., Rifkin’s *The Emphatic Civilization*, 2009).

Mainstream economics remains discomfited by such a concept. More comfortable for the profession is the default hypothesis: development entrepreneurship—if at all—is a random mutation generated by, say, a Poisson process. We have no power to influence it so we don’t dwell on it. It is like the equatorial paradox in Growth Economics. You cannot rule it out; but as it does not help policymaking we turn to other more tractable factors.

Perhaps it is time to interrogate this default hypothesis of pure randomness and exogeneity. After all, the history and growth of the economics discipline is a litany of once-exogenous variables rendered endogenous to ample harvest (e.g., total factor productivity [TFP], innovations, institutions). Perhaps there are regularities here—not yet in the caliber of laws—that can be exploited.

It must be noted that a non-selfish gene need not be involved in development entrepreneurship. There could be two phenotypes of the same genotypic selfish gene. One views its individual well-being as divorced from that of the polity and the other sees its individual well-being as coursed through its social group. The differentiated expression is generated by circumstances which can allow manipulation. An example of the first type is Olson’s roving bandit; an example of the second is his stationary bandit. Both are selfish, but the latter finds it more profitable to become Hobbes’s Leviathan with a stake in his subjects’ well-being and productivity. Machiavelli’s enlightened Prince, who refrains from expropriating his subjects’ properties and their women, does so, not so much from altruistic motives but from the imperative to survive in an environment of contestable sovereignty. The Prince needs
the loyalty and the industry of his people. President Ramos—who played a prominent role in water and telecoms reforms—was acutely discomfited by cross-country comparisons showing the Philippines lagging far behind. He thus operated as a legacy executive, one who finds inspiration in the fond remembrance of progressive future generations. Schneider and Teske (1992) also show that competition among different political jurisdictions leads to institutional change. The fact that inter-group competition can engender group-phenotype was already the message of Darwin’s other volume The Descent of Man (1871).

The stories documented here suggest other possible enablers. Two types of people can be identified: those within government and those outside government. The non-government people who got involved (Hederer [2007] calls them “propagators”) were either connected with academic institutions which did not discourage policy engagement or people of independent means. The government people who figured prominently had mandates from the electorates to mind the problems of the polity and were compensated to do so. Both types had the time and space flexibility to pursue activities not directly contributive to their financial well-being. Both types also exhibit relative financial security. But even then, meaningful reforms are risky and could be costly for those who advocate them. It can cost one’s job or a lawsuit. The default state of players is important in case of failure. Government people—whose default state is uncomfortable—often decide to play it safe, pursue non-controversial, pro-forma reforms, if at all, and still get re-elected. Those whose default state is comfortable (i.e., who do not need the position) take the plunge. Having space-time flexibility and relative financial security seems necessary—but not sufficient—to indulge one’s group-phenotype. This phenotype will remain unexpressed if unaccompanied by these two enablers.

**Development Entrepreneurs, Lobbyists, and Revolutionaries:**

The Hierarchy of Political Settlements

DEs, lobbyists, and revolutionaries have one thing in common: they all work to change the status quo. They are all political entrepreneurs (PE) (Hederer, 2007). How does a development entrepreneur differ from the other two types?

Consider the status quo as a hierarchy of nested political settlements. An “overarching political settlement” (OPS) sits atop and nests all other political settlements. This overarching political settlement corresponds to a fundamental document many times identified with—but need not necessarily be — a constitution. The OPS embodies the (i) goals that the social covenant
is designed to pursue (say, the summum bonum as seen by the polity); (ii) the fundamental principles guiding and limiting the pursuit (such as the separation of church and state, private ownership, and one-man-one-vote); and (iii) the instrumental bodies (such as the government branches in a tripartite system of government). We use the shorthand $G$ to delineate (i) and (ii). An example of $G$ is “the greatest good for the greatest number’ under private ownership and ‘one-man-one-vote.’” The OPS is many times ratified as a political settlement via a national referendum.

Under the OPS are a bevy of “subordinate political settlements” (SPS) in the form of laws, executive orders, etc., each designed in theory to implement $G$ set down in the OPS. An EO is an SPS issued by the executive branch. Laws are SPSs passed by the legislative branch. There is no guarantee of the effectiveness with which each SPS serves $G$. Some SPS may, indeed, subvert $G$—either deliberately or as unintended consequence. Some SPS may transfer resources from one pocket to another such as high tariff protection. The contents of $G$ may allow multiple interpretations and the judicial branch is the final arbiter among these.

A revolutionary is a political entrepreneur out to undermine and replace the OPS; a development entrepreneur is a political entrepreneur who accepts the OPS but is out to replace an SPS that serves the interest of a minority with one that serves the interest of the majority. The lobbyist is a political entrepreneur who accepts the OPS and is out to replace an SPS with another SPS that serves the interest of the particular group that remunerates the lobbyist. The lobbyist is re-distributive PE. The DE is a value-adding PE. The lobbyist is a self-phenotype while the DE is a group-phenotype.

The Deng Xiaoping who—as part of the communist movement—toppled the overarching political settlement lorded over by Chiang Kai Shek in 1949, was a revolutionary. The Deng Xiaoping who rejected a gamut of SPSs under Mao (collective farming, the Great Leap Forward, the state monopoly of the delivery of goods and services) and offered, instead, a gamut of replacements under the banner of “Socialism with Chinese characteristics” under the same OPS, was a development entrepreneur (Deng Xiaoping, 1984). The revolutionary goes to battle with bombs, bullets, and a knowledge of the lay of the land; the development entrepreneur goes to war with technical and political analyses, and the detailed lay of the political landscape supporting the target SPS.

DEs, lobbyists, and revolutionaries have other similarities. None of them is a permanent state, like the priesthood or being male or female. A DE in one arena may be a lobbyist in another. Many revolutionaries first started as DEs but switched after being disillusioned. A lobbyist may switch to development entrepreneurship after a “Saul of Tarsus moment.” They face a fundamental
uncertainty about the success of their enterprise. A development entrepreneur marches to a different drummer than the general run of people. His pursuit being the collective good, his motivation cannot be the financial returns to the enterprise. Development entrepreneurship is a kind of insanity. That is why it is difficult for economics to digest it. But development entrepreneurship as the embodiment of human agency seems most in keeping with the Paris Declaration (Organization of Economic Co-operation and Development – Development Assistance Committee [OECD DAC], 2005) imperative of “local ownership” and the NIE caveat of “change in belief systems and norms.”

Summary

In the previous parts, we summarized the evolution of development thinking leading to the emergence of institutions and human agency. We started with the mechanical models of the post-WW II era, where human agency is effectively abstracted by clever assumptions—a benevolent government and economic agents rendered powerless by abundance. They also succinctly rendered the development problem in understandable gaps. The most famous of these, the financing gap, made external aid agencies the central player in development. But it proved wanting.

The policy gap view of the 1980s—culminating in the Washington Consensus with its emphasis on conditionality and externally driven change—also proved disappointing as it ran into the Samaritan’s dilemma, agency problems, strategic behavior by donees, and even donors with ulterior motives. In other words, they lacked local ownership.

The new century saw the gradual ascendancy and eventual embrace of institutions as central. Cross-country evidence, however deficient and scattershot, corroborated country case studies to confirm that good institutions spell the difference. If this new view was to engage our attention, institutions must be rendered endogenous. Since institutions are artifacts of human agency, this puts human agency at the center of the development process. How does a polity acquire good institutions remains the development challenge of our time.

Is there a master narrative that governs institutional change? In this paper we propose that if there indeed is one, collective action capacity should be an ingredient in this narrative. We propose that institutional change is—like building a public infrastructure—a collective action challenge. As such, it quickly runs into the “Olsonian free riding,” and into the murky waters of politics and political settlements. Thus, it requires a strong collective action capacity to bring about. Development failures and collective action failures
are many times fellow travelers in development annals. Collective action capacity may fail to enhance the public good either because it is weak and/or because it is wrongly directed.

In some countries, history has begotten a strong collective action capacity; in these cases, collective action has to be redirected to the right ends. This, we argue, is what happened in the PRC in the last two decades of the 20th century, thanks to the exertions of Deng Xiaoping. In many more countries, the capacity for collective action is weak. And precisely because of weakness, it was generally trained towards rent extraction from the most powerless to support tenuous political settlements. For example, the incapacity of the Philippine state to enforce its sovereignty over Maguindanao led to an implicit political settlement, which gave the Ampatuan clan a monopoly of violence and rent-extraction powers over the area. The members of the press and of the opposing clan that entered—and were believed to be subsequently massacred by the Ampatuans on their own sacred ground—were defying this political settlement. In these polities, collective action capacity must be at the same time strengthened and redirected.

Guided by the cases documented here, we suggest that an important sub-narrative of institutional change is the role of development entrepreneurship displayed by indigenous actors or organizations. Depending on the polities, development entrepreneurship either redirects or strengthens and redirects collective action capacity toward more inclusive outcomes. The actors displaying development entrepreneurship identify binding constraints toward more inclusion and organize the coalitions and networks that work to lift those binding constraints. The members of the press and of the opposing clan who defied the political settlement with, and were subsequently massacred by, the Ampatuans, were following the dictates of development entrepreneurship. To replace the old political settlement, they paid with their lives.

It is clear that development entrepreneurship comes under the general rubric of political entrepreneurship, of which much has been written. We differentiate DEs from other agents of social change—such as lobbyists and revolutionaries—by mapping their change targets against the hierarchy of nested political settlements. This starts with OPS, under which exists a collection of SPS. Revolutionaries work to replace the OPS; DEs and lobbyists work to replace an existing SPS—DEs by an SPS that serves greater social inclusion; lobbyists by an SPS that serves or preserves social exclusion.

We also suggest some factors that may render DEs tractable and endogenous. We classify agents as either self-phenotype or group-phenotype of the selfish genome. One is a selfish agent who views his private well-being as divorced from that of the polity’s and the other views his private well-being
as unbreakably wedded to the well-being of the polity. Group competition may make the group-phenotype more likely. Likewise, space-time flexibility and relative financial security may help engender more group-phenotypes, and thus, development entrepreneurs in the population.

References


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