

9 Does Economic Growth Lead to Political Stability?

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1 INTRODUCTION: GOOD GROWTH OR DESTABILIZING GROWTH?

There are two contradictory answers to the question in the title. The first is the *good growth hypothesis*: economic growth generates higher incomes, which should make people approve of the government. Hence growth generates stability. The second is the *destabilizing growth hypothesis*: growth generates complex changes in society, and therefore instability. A part of the instability will be political, so that where the political system is not well established, growth could lead to political instability.

Much has been written in defence of both positions. The problem is that there is scant evidence, and most of it is anecdotal.¹ The aim of this chapter is to sift through the evidence and analyse the theory. It is intended to be easily accessible to both economists and political scientists, so we shall limit ourselves to examining three main themes (T1, T2 and T3), where there is a large body of literature which falls squarely between economics and political science:

T1: *Political transition* Countries in economic transition, are also subject to a ‘grand’ underlying pattern of socio-political change, which transforms the traditional system into a modern one. These socio-political patterns are weak, somewhat stochastic and long-term. This is discussed in Section 3.

T2: *The vote and popularity (VP) function* The VP function is used to analyse the influence of economic development on government popularity. This essentially short-term phenomenon is discussed in Section 4.

T3: *The macro strike function* This is used to analyse the reaction of industrial conflict to economic development. This is another short-term effect and is the subject of Section 5.

2 CONCEPTS, CAPITALIST WELFARE DEMOCRACIES AND INCOME DISTRIBUTION

The concept of political stability is clarified in Section 2.1. Section 2.2 discusses the question of convergence. We propose a conditional convergence hypothesis, which states that if countries were to converge, it would be to a capitalist, welfare, democratic (CWD) type of country. In Section 2.3, the possible causal chain from growth to political stability via income distribution is addressed. However theoretically promising and attractive policy-wise, the causal link is, admittedly, empirically weak.

2.1 The Concept of Political Stability

Whereas economic growth is a well-defined concept, political stability is not. Table 9.1 sets out the four dimensions of political stability: S1 – stable government; S2 – stable political system; S3 – internal law and order; and S4 – external stability. Further subdivisions would be possible, but the four aspects S1 to S4 are sufficient here, and we shall largely disregard S4. Think of a few countries and it will be apparent that a lack of stability is common; Angola, for example, suffers from a lack of all four stability conditions, Bolivia from S1, S2 and S3; Japan, although otherwise stable, suffers from S1; and Colombia is stable but lacks S3, and so on.

The analytic themes T2 and T3 suffer from two drawbacks: first, the relevant literature deals mainly with developed countries (DCs); second, only a part of the stability pattern is explained; for example, the strike function, T3, cannot cover the whole field of internal order under S3.

2.2 Conditional Convergence and the CWD Economy

From a political perspective, traditional societies are very diverse. Developed countries tend to be more similar. Figure 9.1 illustrates a dual pattern of most countries converging, with a few lagging behind. The evidence shows that, post transition, the successful countries become capitalist welfare states and democracies (CWD). They are capi-

Table 9.1 Four aspects of political stability: (S¹) to (S⁴)

<i>Narrowly defined</i>		<i>Broadly defined</i>	
S1	Stability of <i>government</i> Does it rule for a full election period and have a majority?	S3	<i>Internal law and order</i> A sub-aspect is the level of industrial conflict
S2	Stability of <i>political system</i> Do governments change legally according to a constitution?	S4	<i>External stability</i> Are the borders of the country contested or actively threatened?

talist in the sense that the means of production is in private ownership combined with mainly free trade; they are welfare states because public-sector spending accounts for between 30 and 50 per cent of GDP. Of this, 20 per cent is spent on public goods, the remainder on redistribution. These countries are all democracies, and the political system is supported by a huge majority of the population. Governments may be unstable, but the system is not. CWD countries tend to be at peace internally and externally. North-west and central Europe used to be a

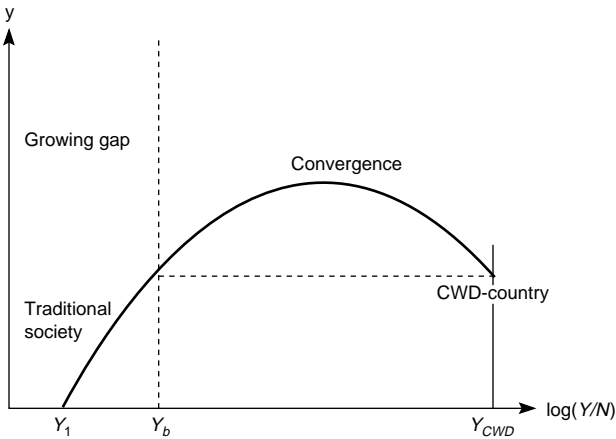


Figure 9.1 The average cross-country growth diagram

Note: $\log(Y/N)$ is the logarithm of real GDP per capita in one year; y is the average (over 1–2 decades) of the real growth rate of per capita GDP.

very violent region, but it is now a region of CWD-countries, and nobody expects these countries' borders to be changed by war.

During the 'youth revolution' of the 1970s it was often argued that a CWD state was only a stepping stone to some other system. Certainly, some key economic indicators, particularly the wage share and public-sector spending rose – apparently inexorably – towards a ceiling that might have led to system changes. The rate of inflation also rose.² The upward trend was reversed by the downward kink of 1974–5. The cure proved costly, but the CWD states endured. Now, new Asian CWD states seem to be emerging. This view might be challenged as naïve and based on too little evidence, as the first CWD countries emerged only in the late nineteenth century, and only forty CWD countries exist.

2.3 Two White Boxes: Growth/Income Distribution and Income Distribution/Stability

Economists speak of 'black boxes' when the connecting mechanism of known linkages between variables described by stylized facts is not fully understood. Although a multitude of theories exist on growth and stability, the data fail to confirm these theories. I have adopted the phrase 'white boxes floating in a black void' to describe this. Two 'white boxes' concern the two links in the causal chain from growth to political stability via income distribution – growth \Rightarrow distribution \Rightarrow stability.³

Growth \Rightarrow income distribution There is a weak and probably negative link. Most studies have shown that with increasing growth, measures of income distribution become skewed in the medium term. This finding is supported by basic economic theory, so it probably holds.

Two contrary effects influence this. First, by generating wealth, growth causes income distribution to become skewed; second, by generating employment growth equalizes income distribution. The first effect probably outweighs the second, although not in the long run and there will be exceptions. The problem is that the reverse linkage that distribution \Rightarrow growth also holds. This is discussed in Sections 3.1 and 6. This brings us to the second link:

Distribution \Rightarrow stability The link here is even weaker, but probably positive. That is, it is probable that a more equal distribution of income will promote greater political stability.

The belief in a positive income distribution \Rightarrow stability connection is attractive because it leads to agreeable policy conclusions, and appears reasonable in the sense discussed by Bourguignon and Morrisson (1992). Much of the evidence supporting these theories is anecdotal, and in the end the stylized facts just seem elusive. I have been unable to find a single cross-country study, which shows a statistically significant causal link between income distribution and political stability.

3 TRANSITIONS

There are numerous studies of economic transition – the process of change from a traditional, stagnant economy to a rich CWD economy⁴ – which show that it has profound consequences throughout society. The process of demographic transition is also well understood. We contend that a political transition is also necessary. Transition is often studied using statistical analyses based on cross-country data. Figure 9.1 illustrates this with a growth diagram showing the average growth rate over ten to twenty years for selected countries plotted against the logarithm of real GDP per head. Other economic indicators can also be compared in this way – for example, income distribution.

Laursen and Paldam (1982) and Andersen (1994) prepared numerous examples of this type of graph for different decades. Unfortunately, they found that the growth diagram only explained 10 to 20 per cent of the variation pattern in average growth rates. In Figure 9.1 all countries to the left of point Y fail to catch up, while those to the right of Y converge to the CWD state Y_{CWD} , as discussed in Section 2.2. It is possible that there is a low-level equilibrium trap around point Y , which inhibits the onset of growth, but this is empirically dubious. Countries lying between Y_1 and Y_b are, however, likely to reach the Y_b point.

3.1 Tensions during Economic Transition

Figure 9.1 reflects the expected pattern, based on current knowledge of economic transition. The most robust findings confirm the *sectoral shift*.⁵ Several variants have been observed corresponding to different development strategies. Although a broad pattern is discernible, there remain crucial unexplained lacunae. In parallel with the empirical literature, the *duality model* was developed, originally by Lewis (1958), but later refined and developed by numerous economists, including Fei and Ranis (1973). The basic findings were:

1. Economic transition entails large sectoral shifts, created by differences in sectoral productivity, which can be of the order of 2 to 5 times;
2. These sectoral productivity differences cause potentially large 'growth bonuses' in the form of 'Petty effects'⁶: the effects of people shifting from low to high productivity sectors.

A productivity difference of 3 would mean that a move of 2 per cent of the labour force from a low to a high productivity sector would generate additional growth in GDP of about 3 per cent. Petty effects are potentially most powerful when countries are midway through their transition. However, to obtain these effects one must have growth. The Petty effect could be seen as a growth multiplier, which tapers off as the country emerges from the transition period. This would help to explain why countries well into transition sometimes enjoy dramatic spurts of growth, as noted in Gerschenkron (1962). This leads to a third observation:

3. Sectoral differences are greatest midway through transition. This explains the *Kuznets (1965) ∩-shaped distribution* diagram. It appears that countries are most equal at both ends of the scale and least equal during the middle phase of transition. This finding has recently been challenged by new research by Zou (1995), but the new results are not yet fully analysed. Unfortunately, the Kuznets ∩-curve, like the growth diagram, offers an inadequate explanation as it accounts for only a small fraction of the variation.

Clearer results from the *distribution ⇒ stability* relation would have provided a neat link between economic and political transition as growth may be greatest around the halfway mark, but at that point distribution is most skewed. Consequently, severe socio-political tensions arise, causing political instability.

3.2 Political Transition (T1)

In the introduction we argued that political transition leads to a democratic system, and that, in general, modern democracies tend to be more alike than traditional political systems. Traditional Eskimo or nomadic societies have virtually no political system. At the other extreme, one finds the high cultures of Ancient Egypt, the Mayas or China, which evolved into highly structured, stable, theocratic societies. Yet other traditional societies formed stable, hereditary, feudal sys-

tems, headed by some type of king. The few traditional kingdoms that still exist are all archaic, except for a few democracies that maintain a symbolic ceremonial monarchy.

It is not easy to make the transition from a traditional political system to a modern democracy. Political instability is a feature of transition, with regimes alternating between military and democratic governments. Today, only a couple of traditional political systems survive in either Africa or the Islamic/Arab world. Many of these countries experienced a period of colonization by a European power, which effectively ended the traditional pattern, and instilled the ideal of some type of democracy. The few countries that have remained democratic have made little progress with economic transformation. We have simplified the complexity of political transition (PT) by dividing it into three phases:

- PT1 Traditional systems;
- PT2 Transition instability; and
- PT3 Stable democracy.

Democracies may be unstable for long periods during PT2, before becoming properly established. Nearly all stable democracies have emerged from successful economic transition. The change to a CWD society probably occurs after a series of political and economic crises, after rapid growth halfway through the transition period, when social tensions are at their greatest. This conclusion establishes a definite, if *weak, link between economic growth and political instability.*

There are several distinct transition strategies. The two we discuss are the import–substitution–industrialization (ISI) model and the export–promotion (EP) model. A third, the resource-rich (RR) strategy, will be commented on.

3.3 The ISI model

The ISI model follows a strategy of state-controlled, protected industry paid with funds squeezed from the consumption of imports and agriculture. This was the strategy pursued by the less developed countries (LDCs) during the 1970s. Most observers today regard this as something of a cul-de-sac, unlikely to bring about successful economic transition. During parts of their transition phase, France and Germany managed a successful ISI strategy; South Korea and Taiwan also followed this model for a decade, but it was only when they changed to an EP strategy that growth took off. It has been argued that an ISI

period is needed before the EP model can be introduced, but this is debatable.

There are numerous examples of aborted transformations – notably in Africa and Latin America – where ISI policies created political coalitions, which maintained state control well into rent-seeking phases, creating high inflation with low growth. Part of the problem is that these countries continue with over-regulation, while the nominal economy escalates, thus undermining political stability.⁷

As there is no external brake on rent-seeking, ISI countries inevitably become soft-budget-constraint economies. This changes the distribution game from a zero sum one into a negative sum game. When firms are not operating under competitive conditions profits are best made by rent-seeking. Once employees discover what soft-budget-constraints are about, inflation becomes hard to control. It is surely no accident that Latin America, a region with low trade and high protection, is also one of high inflation.⁸

It is easy to show that high inflation is politically destabilizing, and that unstable political systems are inflationary. Paldam (1987) and Remmer (1991) both tested this hypothesis using data for Latin America. The mutual reinforcement of political instability and inflation goes a long way towards explaining development disasters in Argentina, Peru and Uruguay. It is well known that inflation of over, say, 30 per cent a year is detrimental to economic growth (Paldam, 1994). This is partly because the political instability generated by high inflation inhibits investment, as shown by Borner, Brunetti and Weder (1995).

An ISI strategy requires the agricultural sector to be squeezed in order to build up the modern sector. Krueger (1992) found that farmgate prices were reduced on average by one third in these LDCs. The Harris–Todaro model chosen by Williamson (1988) predicted that this would result in a depressed agricultural sector and an overstuffed, sluggish high-income ISI sector, with high urban unemployment and a low-income informal sector. As most LDCs followed an ISI strategy, this might help to explain the Kuznets \cap -shaped curve.

3.4 The EP Strategy: The Newly Industrializing Country (NIC) Puzzle

Until a decade ago, few LDCs attempted to transform the economy through export-led promotion. This was the strategy pursued only by hopeless, resource-poor, over-populated Asian countries. However against all the odds, these are the countries that made it.⁹ Since the mid-1970s,

it has been clear that an export-led growth policy might work. Different interpretations have been put forward to explain the success of export led growth: (i) neo-classical; (ii) revisionist; (iii) compromise (World Bank, 1993) and (iv) neo-revisionist, as in Fishlow, Gwin, Haggard, Rodrik and Wade (1994). The recipe for success may still not be known, but it is easy to show what not to do: the NICs did not follow the ISI path. The core of their strategy was employment creation through exports, not wage increases through rent-seeking. By expanding exports dramatically, employment rose and with it the demand for agricultural products. This meant that no tax squeeze on agriculture was needed. This, as shown by the World Bank (1993), led to a more equitable development process.

In most NICs there has been a simple one-step political transition, with military rule being gradually replaced by some form of democracy. Japan illustrates this clearly, with a traditional theocratic regime giving way first to a turbulent military regime from the 1920s until the end of the Second World War, followed after 1945 by a docile democracy. A similar development is now taking place in other NICs.

3.5 A Note on the Paradox of RR Countries

It is a disadvantage, as noted by Syrquin (1988), to be resource-rich. The RR strategy was to export their resources and use the rent to build a modern economy. This has proved remarkably difficult. A resource exporting strategy reduces the economic growth rate by about 1 per cent a year. Furthermore, inspection of the statistics reveals that spectacularly resource-rich countries, such as Zaire, Zambia or Brazil have performed relatively poorly. The oil-producing countries had high GNPs, but they experienced low growth. The oil boom was the start of an economic debacle in numerous oil-rich countries, including Mexico, Nigeria, Trinidad and Venezuela. In fact, some of the richest countries in the world, such as Denmark, Switzerland and the four Asian Tigers are resource-poor. The paradox is that being resource-rich appears to be of dubious advantage, because a RR country gets rich from resource rents, which accrue to the state, making it a very rich country. Because the population of an RR country knows that the state is very rich, large-scale spending programmes have to be undertaken. This results in the twin problems of the *Dutch disease* and *automatic socialism*.

The Dutch disease is the phenomenon of a resource boom causing a revaluation in the real exchange rate. Sooner or later wages increase to enable people to purchase the consumption goods the country can

well afford. But this causes wages to rise faster than productivity – one of the definitions of bad competitiveness. Exports from sectors other than the resource sector collapse, creating serious unemployment problems, but as the state is rich it creates employment in the sheltered sectors producing non-tradables. The result is a large public sector – which I term ‘automatic socialism’. This occurs even in conservative countries, for example in the Arabian peninsula, where the rulers abhor socialism. The trouble is that the ruler needed to do something with the vast inflow of money into the treasury.

An alternative model suggests distributing the resource rents to people as subsidies on, for example, housing, food, gas and so on. This would seem to harm competitiveness less, but leads to another problem. Once instituted, it becomes almost impossible to remove these subsidies when the resource rent falls. The years since the early 1980s, for example, in Venezuela and Ecuador, illustrate the strong ratchet effect of consumption subsidies.

Finally, I would stress that RR countries grew rich without experiencing any economic transformation. They experienced only a partial and skewed transition, in which a large gap developed between the wealth of the country and the development of human capital. That is to say, an archaic political system was sustained far longer than anticipated. Our concern here is whether a RR strategy produces political stability. Two points are obvious: (i) governments preside over large-scale wealth creation; and (ii) few people would consider the RR government in fact responsible for this wealth creation, as it only distributes wealth accruing from the resource. There is no reason, therefore, to expect RR countries to be politically stable, and the government may need to buy stability, by creating support coalitions, to survive.

4 THE VP FUNCTION: FROM GROWTH TO GOVERNMENT STABILITY

The voters’ popularity (VP) function relies on the *responsibility hypothesis*. This states that voters hold the government responsible for the economy. It has proved a fruitful hypothesis, for two reasons: first, because it predicts that economic prosperity will increase government popularity; and second, because this prediction can be analysed by studying simple operational relations such as:

$$V_t = \alpha_0 + \alpha_1 y_t + \alpha_2 p_t + \dots + \varepsilon_t \quad (1)$$

where V_t is the popularity over time, and y_t and p_t are economic time series, such as the growth rate or inflation rate, α is an estimating coefficient and ε_t residuals. All that is needed is to collect the relevant data in order to calculate government popularity.¹⁰ Some 200 studies, surveyed by Paldam (1981) and Nannestad and Paldam (1994), have been undertaken in this field. These studies confirmed the responsibility thesis, except where the government clearly could not exercise real power, because, say, it was a minority government. These results have been obtained mainly from DC data; LDC results, admittedly based on scant evidence, appear similar.

4.1 The Effect, Myopia and Costs of Ruling

VP models such as Equation (1) do not generally include any political variable, and yet it is well known that political scandals and crises affect voting. In general, economic variables are estimated to account for only one-third of the change in the support for RC governments. That is, the state of the economy causes a 1–2 per cent shift in voting pattern. While this might be sufficient to cause a change of government, it will do little to change the political fate of an unpopular ruler.

Most estimates include a coefficient for unemployment. The typical order of magnitude is that a 1 per cent reduction in the rate of unemployment leads to an increase of 0.6 per cent in the votes cast for the government. Many estimates also estimate the effect of real growth on popularity. A typical real growth coefficient implies that:¹¹

it takes about 3 per cent incremental economic growth to get a 1 per cent rise in government popularity.

This finding needs to be modified in at least three ways:

1. *Electoral myopia* Increases in government popularity are short-lived and tend to disappear as the electorate adjusts to economic change. If a boom bottoms out, two-thirds of the popularity gained will vanish within a year. Even continued upward growth will not result in any large permanent gain in popularity. It should be noted that a permanent upward growth kink hastens the economic transition and with it political transition. Myopia is most evident when government popularity is generated by foreign-policy victories – known in the literature as ‘rally round the flag effects’. For example, President Bush’s large increase in popularity during the Gulf War had been eroded

- by the next election.
2. On average, between elections, a government loses 1.7 per cent of total votes cast for it. This finding is independent of the party, election or political system. This means that the cost of ruling will eventually cause a change.

Given this myopia and deterioration of popularity over time, maintaining popularity becomes increasingly difficult. In practice, military leaders do not last longer than elected leaders. Obviously, the more able the government, the more it can counteract this cost of ruling by ruling exceptionally well. One option is for a government to set up lasting coalitions with special groups to ensure lasting support. Some regimes also attempt to deal with these costs by creating a dual system, where the president or monarch appoints a prime minister, who will carry the blame and be forced to resign.

3. Nearly all VP function studies look at government stability. However, some, notably Panzer and Paredes (1991), consider system stability. It appears that myopia is *less* pronounced for systems than for governments. Nevertheless, in the longer run, an unpopular regime cannot win popular approval by following a popular economic policy.

Finally, the literature has come up with one awkward result. The VP function contains a number of tests on mass level expectations, and it appears that retrospective evaluation produces more reliable results than the corresponding expectation variables. Next I discuss two speculative aspects.

4.2 Speculative Aspects (1): The Lack of Income Distribution Results

Here we consider an interesting, but less robust finding. I believe I have read all 200 papers on the VP function and have yet to come across one that establishes any measure of the relationship between income distribution and government popularity. This would be an interesting avenue of research, but there are problems in finding a distribution series with enough variation, especially where quarterly observations are used. The best results to date have come from showing that the VP function changes systematically across income groups, as analysed by Schneider (1978) and Hibbs (1978b). Poor people are more concerned

about unemployment than inflation, while the opposite is true of the wealthy. This allows us to calculate the popularity effects of economic change as it affects these variables and income distribution, but we are probably only dealing with marginal effects.

4.3 Speculative Aspects (2): Grievance Asymmetry

A *grievance asymmetry* may be said to exist where people assess economic change asymmetrically; where, for example, the reaction to a fall in an economic variable is much stronger than that to a rise. While this effect has been found in some dozen studies, others have reported symmetric reactions. A recent study, Nannestad and Paldam (1997), both summarizes the literature and presents new findings, which confirm a strong asymmetric relationship. Given that the electorate bases its evaluation of the future on past events, grievance asymmetry causes voters to punish systematically economic variation.¹² This produces a *general-risk-aversion-like result*, where there is a trade-off between growth and variability. A second risk-aversion-like-result is that the dislike of inflation is greater than makes sense, given the level of damage. In VP functions inflation is typically non-linear: that is, at low levels of inflation, no inflation coefficient is present, so that, $\alpha_2 \approx 0$ in estimates of Equation (1), but as the rate increases it becomes the dominant effect, so that, $\alpha_2 \gg \alpha_1$.

Grievance asymmetry provides a neat explanation of the cost of ruling. Imagine that two economic variables are crucial to a government's popularity, and that an average government manages these two variables and rules as well as any alternative government. If a government improves one of these two crucial variables successfully it must be at the expense of the second, and consequently, the second economic variable must deteriorate. Grievance asymmetry means that the government is blamed far more for the variable that declines than it is rewarded for the variable that improves. This leads to the decreasing popularity of the average government. These observations give the concept of grievance asymmetry greater plausibility, even if there is a lack of evidence. It follows from this that the popularity that might be gained from a prolonged boom will be even smaller than suggested in Section 4.1.

5 THE STRIKE FUNCTION: GROWTH AND INDUSTRIAL CONFLICT

In most countries industrial conflict is a small, highly visible – and mostly fairly harmless – phenomenon. The level of industrial conflict c_t can be analysed in much the same way as government popularity:¹³

$$c_t = b_0 + b_1y_t + b_2p_t + \dots + \varepsilon_t \quad (2)$$

Various measures of industrial conflict are available. The three main measures are: (i) the number of conflicts; (ii) the number of workers involved; and (iii) the number of days lost through strikes. The level of industrial conflict c_t is in practice a macroeconomic variable that can largely be disregarded in connection with production, but it has a certain indicative value for assessing the labour market ‘climate’. To analyse the underlying macro pattern of conflict, one needs to include a large number of conflicts, and no single conflict must have too large a weight. Clearly, taking the number of conflicts as the measure assigns the same weight to each conflict, so c_t is the proper measure here. Where comparative studies are undertaken, this must be expressed relative to the size of the country’s population.

The c_t variable will be positively correlated to other measures of civil unrest. Analysis of time series of industrial conflicts in nearly twenty countries shows that fewer strikes occur in countries with strong central unions and a well-developed body of labour law.

5.1 The Crucial Finding: Growth Causes Conflict

The crucial finding is that there is a strong positive correlation between price–wage inflation and the number of industrial conflicts, and that this causality works in both directions. Conflicts cause inflation, and inflation causes conflict. This would explain the highly conspicuous inflation/conflict waves that occur in most countries from time to time. Evidence suggests that the positive connection is stronger for wage than price inflation. This means that there is a positive correlation between real growth and industrial conflict. Nothing in the literature suggests that any measure of wage inflation reduces conflict. This leads to the conclusion that: *real growth causes an increase in the number of industrial conflicts*¹⁴ and this, by making society more volatile, makes it less politically stable. Given that conflict causes wages to rise, we clearly have a mechanism whereby real growth is inflation-

ary. Inflation is known to be destabilizing, so we have established a causal link, albeit a weak one.

Higher growth reduces unemployment. Thus a link between unemployment and the number of conflicts enters into the causal chain between growth and conflict. The rate of unemployment u will often be significant in relations such as in Equation (2), but an enigma waiting to be solved is why in different countries and at different period u may produce a positive or a negative effect.

Two highly significant institutional factors need to be considered: (i) union structure and size; and (ii) the political dimension. These will differ between DCs and LDCs. DC labour markets tend to be relatively homogeneous across sectors, so that employees' wages and productivity – given a similar standard of education – will tend to be similar. This encourages national unions. In North-west Europe, for example, it will be found that central unions tend to ally with the dominant labour party. In these social democratic countries the number of industrial conflicts has decreased, whereas in Southern Europe, where the labour movement has remained fragmented, industrial conflicts are frequent. Nevertheless, in both types of country the reaction to growth is an increasing number of conflicts.¹⁵

The political element is more complex. One can distinguish between *normal* conflicts – related to conditions of work, and *political* conflicts – intended to put pressure on politicians. The latter are more likely to lead to political change. The data rarely allow for this distinction between types of conflict, and even where this is possible the two will be found to be highly correlated, just as strikes and civil unrest are correlated. In most LDCs the labour market is fragmented, making it difficult for central unions to develop. On the other hand, political conflict tends to be frequent. There are many reasons for this, such as the cost of going on strike. Under a dictatorship that suppresses strikes, labour activists are likely to be severely punished, so the cost of striking will be high. This results in fewer strikes, but when they occur they tend to be severe, and beyond a certain threshold, a strike may explode into an anti-government conflict.

5.2 LDCs: Conflicts, Stabilization and Growth

The problem of social unrest and strikes is also dealt with in the literature on stabilization policies and structural adjustment. The main findings are summarized by Frey and Eichenberger (1994) and Haggard, Lafay and Morrisson (1995). All countries are liable to balance-of-payment

crises, but stagnating countries with exploding nominal economies, as discussed in Section 3.3, are particularly prone to these. In these countries there is an underlying structural problem. They need to follow a stabilization policy to deal with the balance-of-payments crises, and a structural adjustment policy to deal with the underlying problem. They may turn to the IMF. The IMF has developed a standard stabilization package, and, together with the World Bank and regional development banks, structural adjustment packages. These packages, which involve reducing public expenditure and moving people out of jobs, are frequently unpopular in the short run. Many of them have therefore failed. Most would work if carried out to the letter, but they fail because people react badly to them. That is, attempts to implement the packages have led to mass demonstrations, strikes, riots and even coups, finally forcing the government (or incoming government) to abandon the policy. Renewed crises force countries to return to the IMF for help, whereas an economy that performs well, and a government that enjoys a high level of credibility, can adjust to a crisis, and quickly regain its growth path.

With regard to stabilization policy, it is widely held that a country might be trapped in a vicious cycle of low growth and political instability. This may be seen as the reverse of the good growth hypothesis. All the literature suggests that the macro strike function adds support to the destabilizing growth hypothesis.

6 CONCLUSIONS

This chapter has attempted to summarize the state of knowledge in a field dominated by belief and opinion. First, we introduced two contrasting hypotheses: the *good growth hypothesis* and the *destabilizing growth hypothesis*. The *good growth hypothesis* is probably the more widely supported, and holds that as economic growth is good for people, it must also promote political stability. This is the ‘good circle’, a reinforcing mechanism where growth creates political stability and vice versa. There is a corresponding ‘bad circle’ that generates low growth and low stability. This phenomenon might explain the development disasters in countries such as Argentina. However, there are also numerous cases where high growth has led to political change: Iran and South Korea, for example, where high growth led to an archaic theocracy in one and democracy in the other. These examples support the destabilizing growth hypothesis, and confirm that growth leads to profound change in society including political change.

To conclude, much of the evidence is weak, even contradictory. In Section 3 we considered theories of, and evidence on, economic transition; in Section 5 the macro strike function. Both appeared to support the destabilizing growth hypothesis. On the other hand, Section 4, which dealt with the VP function, supported the good growth hypothesis, because government popularity increased. The effect, however, was of short duration. On balance, what evidence there is offers weak support for the good growth hypothesis.

Notes

1. Two examples may suffice. The longest-ruling economist was no doubt Professor Antonio Salazar, dictator of Portugal, 1932–68. He tried to prevent economic growth, but sought political and social stability. Observers of the ultra-capitalist growth miracle in Communist China sometimes wonder how long the political system there can survive.
2. Many saw these trends as confirming Schumpeter's (1952) prediction of an inevitable march towards socialism; now the socialist alternative no longer appears a serious alternative. This has led Fukuyama (1992) to predict the 'end of history', where all countries would become placid, peaceful CWD states.
3. The two main concepts are: (i) the personal distribution as measured by the gini-coefficient or a fractile ratio; or (ii) the functional or class distribution as measured by the factor-wage share or the wage share. Unless explicitly stated, all references are to (i) when discussing distribution.
4. The first modern transition studies were Clark (1957) and Kuznets (1965 and 1966). Later studies included Adelman and Morris (1973), Chenery and Syrquin (1975), summarized in Syrquin (1988). Growth and distribution aspects are covered by Chenery *et al.* (1974), and Adelman and Morris (1989).
5. The basic shift pattern is primary \Rightarrow secondary \Rightarrow tertiary. The primary sector starts at around 70 per cent and converges to almost zero; the secondary sector starts at zero, and tapers off after reaching 30 per cent; the tertiary sector starts at 25 per cent and remains constant during the first part of the transition; it grows larger as the secondary sector levels off.
6. Sir William Petty (1623–87) noted the effects on growth from a change in sectoral composition. These effects depend on the relative size of the sectors. The effect is greatest when the high-productivity sector is small. The Petty effects are likely to be greatest midway through the transition.
7. Historically, many countries tried to regulate economic activity beyond their *capacity to regulate*. The result is often a surprising waste and inefficiency in institutions, and a long-run loss of credibility. The answer to failure in regulation has often been the introduction of yet more regulation, creating new problems leading to more regulation, and so on.
8. ISI strategies were introduced in Latin America in or before the late 1940s.

In Africa they were introduced twenty years later. African countries experienced high Latin-American-type inflation some two decades later, during the 1980s.

9. Hindsight is easy, but I remember that prevailing opinion in the 1960s considered Taiwan, South Korea and Hong Kong to be poor outsiders among the group of LDCs. Later they were too busy increasing exports to fight for a New Economic Order within UNCTAD.
10. The relation has been analysed at both macro and micro levels, using many different variables with different lags. Different non-linearities have been examined and system estimations used to account for possible bias.
11. Unemployment and growth show considerable multicollinearity. The estimates are consistent with the typical Okun-relation, where 2.5 to 3 per cent additional growth leads to a 1 per cent fall in unemployment.
12. IDB (1996) provides evidence of the cost in growth from variability and argues that governments generating variability lose in two ways: (i) people turn against these governments; and (ii) in the longer run, economic growth slows down.
13. Since the mid-1980s little has been written on this topic. See Hibbs (1978a and 1978b), Paldam and Pedersen (1985), and Kennan (1986).
14. The reverse sign appeared in US data for the 1950s and 1960s given in Ashenfelder and Johnson (1969). This is probably a fluke.
15. While the long-run effect of left-wing government was a fall in the number of conflicts, there have been interesting opposite short-term results when a political shift to the left led to strikes. A probable explanation is that workers felt they deserved immediate rewards once their people gained power. This means that some left-wing governments start their rule at a disadvantage. This may be destabilizing, but it does not affect growth.

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