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Polarisation, uncertainty and public investment failure

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Abstract

In a political economy model, the effect of political polarisation on a government's intertemporal choice between redistribution and public investment is shown to be similar to the effect of political uncertainty. Moreover, polarisation and uncertainty reinforce one another in their impact on public underinvestment and may ultimately lead to no investment at all.

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1. Introduction

Political polarisation captures the phenomenon that societies are not homogeneous, but made up of different groups, which are often competing for political influence. Such heterogeneity can be based on ethnic, linguistic, religious diversity, income distribution and/or other social characteristics. Abstracting from the specific type of heterogeneity I model polarisation as the degree, to which the government favours one group over another, i.e. the degree, to which the heterogeneity actually matters for decision making. In a political economy model I can show that polarisation has similar effects as political uncertainty (government's chance of losing power) in producing public underinvestment. Probably the most important result is that polarisation and political uncertainty reinforce one another in their effect on underinvestment. Ultimately, this may lead to total public investment failure. This finding helps explain, for instance, that many

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developing countries, especially in sub-Saharan Africa, suffer from poor public services in health, education, infrastructure, etc. despite large public expenditure (Pradhan, 1996).

The effects of political uncertainty (sometimes called political instability) are well documented in the model-theoretic literature. Most papers are two-period models. The chance of a change of decision maker who might take different, less desirable, decisions in the second period produces a negative spill-over onto the incumbent decision maker in the first period. Future outcomes and the effects of today's actions onto the future are more heavily discounted. In Cukierman et al. (1992), for instance, the result is higher seigniorage revenue today instead of economic reform effective tomorrow, in Devereux and Wen (1998), it is higher public activity and lower growth. Tabellini and Alesina's (1990) median voter typically chooses to borrow from the future to pay for higher public goods spending today.[1] However, none of these models disentangles the effects of polarisation from those of political uncertainty, even though agents have preferences over two types of public goods.

In contrast to political uncertainty, polarisation has only been scrutinised under specific circumstances. On the one hand, there is a lot of empirical evidence documenting the key role of political polarisation for growth collapse and development failures.[2] Easterly and Levine (1997) find that, empirically, ethnic diversity is the single most important cause of slow growth in Africa.[3] Collier and Gunning (1999) argue that ethnic diversity promotes ethnic favouritism, i.e. diverting public spending to ethnic groups instead of creating better conditions for the whole of society.[4] On the other hand, there is the literature on clientelism.[5] Robinson and Verdier (2002) analyse clientelism in a game-theoretic framework with an asymmetric political structure. It is optimal for patrons to invest too little in public services while overproviding public employment, which they demonstrate to be an "incentive-compatible way for patrons to control clients."[6]

This paper acknowledges that political uncertainty (chance of losing power) and polarisation (heterogeneity) are distinct empirical phenomena relevant for both developing and more developed countries. The political economy model I present abstracts from specific forms of polarisation or political uncertainty and captures directly the trade-off between redistribution and public investment. In an intertemporal public finance model with two rivaling groups, a government can choose between (efficient) public investment and spending on public goods, one of which is only beneficial to one group, the other is only useful to the other group. There is more or less redistribution depending on how much the government prefers one public good over the

[1] Darby et al. (2004) include public investment, but – due to the specific functional format of their production function – they cannot obtain the instability threshold obtained in this paper.

[2] A whole range of empirical explanations and verbal (sometimes anecdotal) arguments are offered by, for instance, Easterly and Levine (1997), Collier and Gunning (1999), Easterly (2001), Hillman (2002), and Gupta et al. (2005).

[3] More specifically, Collier (1998) claims that the negative effect of ethnic diversity on growth is only true for undemocratic countries.

[4] According to a biopolitical study by Tatu Vanhanen (1999), it is natural to the human race to favour kin over nonkin. Discussing "the post-colonial political inheritance" of African countries, Rowley (2000) points out that "the battle for control over the apparatus of government assumed an importance out of all proportion to Western experience as tribes, ethnic groups, and regional interest groups vied for the rents that political control was seen to offer".

[5] Kurer (1993) describes it as follows: "The actors in the model are patrons, clients and non-clients. The patrons are the politicians in power who determine the size and the distribution of government revenue. The clients elect and support their patron politically in return for economic benefits derived from the association with the patron. Class, corporation, or ideology do not influence the behaviour of the clients." Bratton and van de Walle (1994) explain why clientelism (in their terminology neopatrimonialism) hampers the political evolution in Africa.

[6] Robinson and Torvik (2005) obtain a similar result in a different, non-clientelistic model with efficient and inefficient public investment, but no public consumption. They also show that political uncertainty creates incentives to invest in inefficient public works projects.