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The Political Dynamics of Economic Growth

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Summary. — We argue that an understanding of the political drivers of economic growth needs an explanation of the political dynamics around the transition from one growth phase to another, and that the political drivers of early stage growth accelerations are different from that of growth maintenance. Informal institutions are likely to play a role in growth acceleration, while formal institutions of credible commitment, the provisioning of public goods and the overcoming of co-ordination failures will be more important in growth maintenance. We present empirical evidence drawn from country case-studies and cross-country econometric analysis that provides support to our theoretical propositions.

Key words — political dynamics, political settlements, economic growth, institutions, growth phases

1. INTRODUCTION

The process of economic growth and why there are such significant differences in living standards across countries is one of the most important and challenging areas of research in economic development. An early tradition in the very large literature that exists on the determinants of economic growth was mostly focused on understanding the proximate determinants of economic growth, and in particular, the role of human and physical capital accumulation, technological change, and productivity growth in explaining economic growth. However, as North and Thomas (1973) noted, such proximate determinants or correlates of economic growth "are not causes of growth; they are growth" (p. 2). A more recent literature has gone beyond these proximate determinants and attempted to understand the *fundamental* causes of economic growth—"the factors potentially affecting why societies make different technology and accumulation choices" (Acemoglu, 2009, p. 20).

Institutions and geography are widely regarded as the two most important fundamental causes of economic growth (Acemoglu, Johnson, & Robinson, 2001; Sachs, 2003). While these two factors are not necessarily mutually exclusive causes of economic growth, a large empirical literature has shown that institutions—understood as the formal and informal rules that constrain economic and social behavior—trump geography as the dominant cause of long-run improvements in standards of living. While this literature identifies the causal effect of regulations, laws and norms on economic incentives, and in particular, on the incentives to invest in the technology, physical capital and human capital that are proximate determinants of economic growth, it also recognizes that these economic institutions are in large part politically determined, and ultimately reflect choices made and decisions taken by society at large or by some powerful groups in the society. A very new literature has been analyzing why in certain political contexts, growth-enhancing economic institutions emerge and why we see the persistence of growth-impeding economic institutions in many developing countries for long periods of time.

In this paper, we assess what we know (and what we do not know) about the role of political factors in explaining why some countries economies grow faster than others. We begin with a fresh look at the "stylized facts" of economic growth. We identify an important limitation in the past literature on economic growth in that their focus on rates of average growth of per capita income has obscured the fact that most countries observe dramatic fluctuations in growth of per capita income. Most developing countries tend to observe stop–go growth episodes, with growth accelerations followed by growth decelerations or collapses. We argue that an understanding of the political drivers of economic growth needs an explanation of the political dynamics around the transition from one growth phase to another—that is, the political determinants of growth accelerations, growth maintenance, and growth declines/collapses. We then propose a conceptual framework to understand the political channels of economic growth around the transitions from one growth phase to another phase. In developing this framework, we argue that the political drivers of early stage growth accelerations are different from the political drivers of growth maintenance. Next, we use this framework to review the recent theoretical literature on the political determinants of economic growth and relate our conceptual framework to this literature. We then review the empirical basis of our approach to the politics of economic growth, and find suggestive evidence both in qualitative case-studies and in the cross-country econometric literature that supports the main propositions of our approach.

The rest of the paper is structured as follows. We first set out the "stylized facts" of economic growth in Section 2. In Section 3, we sketch out our preferred framework by which to understand the "stylized facts" of economic growth. In Section 4, we review the theoretical literature on the political and institutional determinants of growth through the lens of our framework. Section 5 surveys the empirical literature on the political and institutional determinants of economic growth as well as provides further evidence to support our conceptual approach. Section 6 concludes, and proposes a set of issues that should inform future research on the political drivers of economic growth.

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2. STYLIZED FACTS OF ECONOMIC GROWTH

The standard definition of economic growth is that it is a sustained increase in per capita incomes over a sufficiently long period. The Commission for Growth and Development (CGD, 2008), a multi-donor initiative to study the causes of economic growth, identifies only thirteen countries which have experienced high, sustained economic growth (defined as an average of 7% growth of per capita income or more over 25 years or more). These thirteen success stories are listed in Table 1. Two of these countries are developed countries (Japan and Malta), and one is oil rich (Oman). This leaves only 10 countries from the developing world that have experienced sustained growth in the post-World War II period: Botswana, Brazil, China, Hong Kong, Indonesia, Korea, Malaysia, Singapore, Taiwan, and Thailand. Figure 1 provides the plots of per capita Gross Domestic Product (GDP) (in constant 2005 US Purchasing Power Parity (PPP) dollars) for the 10 developing countries from 1960 to 2008. It is clear that the increase in per capita income for most of these countries (with the exception of Brazil) follows a linear growth process, and that income grew more or less continuously for these countries (except for the period of the 1997 financial crisis, which affected economic growth in countries such as Indonesia, Korea, and Thailand, with Indonesia's growth showing a distinct slow-down since 1997).

There is one important limitation of CGD's approach in identifying economic growth successes, which is also evident in the wider empirical literature on economic growth. CGD's approach of classifying growth successes by high rates of average growth of per capita income misses the point that most countries observe dramatic fluctuations in growth of per capita income. Very few developing countries meet the criterion of sustained high rates of growth—most developing countries tend to observe stop–go growth episodes, with growth accelerations followed by growth decelerations or collapses. As Jones and Olken (2008) point out, "almost all countries in the world have experienced rapid growth lasting a decade or longer, during which they converge toward income levels in the United States. Conversely, nearly all countries have experienced periods of abysmal growth. Circumstances or policies that produce 10 years of rapid economic growth appear easily reversed, often leaving countries no better off than they were prior to the expansion" (p. 582). Therefore, long-run growth averages within countries often mask distinct periods of growth success and growth failure, and "the instability of growth rates makes the talk of the growth rate almost meaningless" (Pritchett, 2000, p. 247). Growth experiences differ over time within a country almost as much as they differ among countries, and identical average growth rates can mask very distinct growth paths (Jerzmanowski, 2006). [1]

To illustrate our point about the very different growth phases that may characterize economic growth for a particular country over a period of time, we present plots of GDP per capita for a random sample of 10 developing countries drawn from Africa, Asia, and Latin America (see Figure 2). The evolution of GDP per capita shows distinct patterns across the 10 countries, and more importantly, within these countries. For example, Argentina has seen both periods of high growth and periods of growth declines. Ghana and Tanzania have seen a prolonged period of stagnation in the 1980s and 1990s, followed by positive growth in the 2000s. Malawi and Zambia have observed prolonged periods of growth collapses. In comparison, Uganda shows a significant growth collapse in the 1970s, followed by rapid growth since the 1980s. It was the reverse in the Congo, with growth accelerating in the 1960 and 1970s, and then stagnating since the mid-1980s. In the case of The Philippines, there were multiple growth phases—there was steady economic growth in the 1960s and early 1970s, followed by a growth collapse in the late 1970s and then stagnation in the 1980s and early 1990s, with growth recovering in the 2000s. Tanzania witnessed a long period of stagnation for three decades in the 1970s to 1990s, with rapid economic growth in the 2000s. Economic growth was low in India till the late 1970s, with a steady acceleration since the early 1980s.

Thus, growth phases vary across time and space—the same growth phase does not characterize countries in the same region and in the same period, and countries which are similar in some respects (such as Ghana and Uganda) show very different growth phase switches. This tells us that exogenous factors such as oil shocks or terms of trade declines may not be causal to growth phase switches, or at least, that their effects of economic growth may be mediated by country-specific variables. The analytical challenge here is to understand what leads to growth accelerations in some countries and not in others, and why do some countries maintain economic growth for extended periods, while in other countries, economic growth declines or collapses after initially accelerating. What explains the likelihood of a country switching from one growth phase

Table 1. *Success stories of sustained, high growth, as identified by the Commission for Growth and Development (CGD, 2008)*

Economy	Period of high growth**	Per capita income at the beginning and 2005***	
Botswana	1960–2005	210	3,800
Brazil	1950–80	960	4,000
China	1961–2005	105	1,400
Hong Kong, China*	1960–97	3,100	29,900
Indonesia	1966–97	200	900
Japan*	1950–83	3,500	39,600
Korea, Rep. of*	1960–2001	1,100	13,200
Malaysia	1967–97	790	4,400
Malta*	1963–94	1,100	9,600
Oman	1960–99	950	9,000
Singapore*	1967–2002	2,200	25,400
Taiwan, China*	1965–2002	1,500	16,400
Thailand	1960–97	330	2,400

Source: CGD (2008).
* Economies that have reached industrialized countries' per capita income levels.
** Period in which GDP growth was 7% per year or more.
*** In constant US$ of 2000.