European Journal of Political Economy 31 (2013) 165–179

Contents lists available at SciVerse ScienceDirect

European Journal of Political Economy

journal homepage: www.elsevier.com/locate/ejpe

Political persistence and economic growth

Giorgio Bellettini [a,b], Carlotta Berti Ceroni [a], Giovanni Prarolo [a,*]

[a] Department of Economics, University of Bologna, Piazza Scaravilli 2, 40126 Bologna, Italy
[b] CESifo, Munich, Germany

ARTICLE INFO

Article history:
Received 17 July 2012
Received in revised form 15 May 2013
Accepted 24 May 2013
Available online 2 June 2013

JEL Classification:
O31
O33
O40
C23
D73

Keywords:
Political persistence
Economic growth
Red tape

ABSTRACT

Using data for a panel of 62 partly to fully democratic countries in the period 1984–2008, we provide evidence that political persistence (measured as the longest tenure in office of main political entities) is negatively associated with growth, after controlling for country and time fixed effects, and that this association is stronger in countries with low bureaucratic quality, where the cost of red tape is high. This evidence can be rationalized by means of a growth model with quality improvements where political connections with politicians can be exploited by low-quality producers to mitigate red tape costs, defend their monopoly position and prevent entry of higher-quality competitors. The model implies a negative relationship between persistence in office of politicians and economic growth in high red-tape countries, while no association is expected where red tape costs are low.

1. Introduction

Low turnover of politicians is a feature of political systems in several countries. For example, in 2002, 398 US House members ran for re-election, and only 16 were defeated, while a mere 3 out of 26 senators running for re-election lost. A recent cross-country analysis of comparative turnover rates, based on lower house legislative elections from 1979 through 1994 for twenty-five countries, shows that the mean of incumbents returning rate is 67.7% (see Matland and Studlar, 2004). For the US, Merlo et al. (2010) report that re-election rate in the Congress between 1951 and 1994 was never below 80%. In Italy, re-election rate in Parliament between 1951 and 2008, though more volatile than in the US, never fell below 60% and was around 80% in several elections.

In some countries persistence in power of members of the political elite is often blamed for dismal economic performance. Politicians are perceived as an inaccessible and self-sufficient core, with long-lasting personal contacts and acquaintances with the economic establishment, that tend to create a system where economic outcomes are driven by relationships more than by the market, preventing access to power of more dynamic individuals, and hindering innovation and economic growth. In other countries, on the contrary, political persistence is much less an issue.

In this paper, we argue that these different perceptions may be due to the different effects of political persistence on growth depending on the extent of red tape and the level of bureaucratic quality prevailing in the country, which is well documented to be highly variable even considering relatively developed and democratic countries. In the presence of cumbersome bureaucratic and administrative requirements and/or inefficient bureaucracy, personal relations with politicians developed through repeated

* Corresponding author. Tel.: +39 051 2098873; fax: +39 051 2098040.
E-mail address: giovanni.prarolo@unibo.it (G. Prarolo).

0176-2680/$ – see front matter © 2013 Elsevier B.V. All rights reserved.
http://dx.doi.org/10.1016/j.ejpoleco.2013.05.002

interactions may become important assets for firms, that can use them to alleviate red tape costs. Networks between incumbent politicians and firms give the latter a lead, that may be exploited to prevent entry of competitors with superior technologies, hindering growth.[1]

To formalize this argument, we use a simple theoretical framework which incorporates political networks in a model of growth where quality improvements take place through the diffusion of (exogenously available) superior technologies. The incumbent monopolist can mitigate red tape costs through political connections, provided that the incumbent politician is confirmed in office, and engages in Bertrand competition with an outside firm, which is endowed with the leading-edge technology but lacks connections. To keep the model as simple as possible, we assume that the incumbent politician faces an exogenous probability of being ousted from office and replaced by a new entrant.

In this framework, we show that if red tape costs are sufficiently large relative to the quality upgrade, the monopolist succeeds in maintaining her position, when the politician is confirmed in office. Instead, if red tape costs are low and/or the politician is replaced, entry of superior technologies cannot be prevented. Our analysis shows that perpetuation of the political status-quo leads to income maximization in the short run, as production costs and prices are lower. In the long run, however, long-lasting networks between incumbent politicians and firms block innovation (in high-cost countries) and are detrimental to economic growth, leading to technological backwardness. More specifically, higher probability that the incumbent politician remains in office (political persistence) implies lower rates of growth in high red tape countries, while it is unrelated to growth in low-cost ones.[2]

In the second part of the paper, we investigate the empirical relationship between political persistence and growth. We measure the former as the longest tenure among main political entities who are in place in any given year, available from the Database of Political Institutions (DPI), and use the index of bureaucratic quality from the International Country Risk Guide (ICRG) as (inverse) proxy for red tape costs. In order to exclude countries with low-quality political institutions and autocratic regimes where replacement of the political elites may involve severe socio-political instability and determine political regime switches that may affect growth through separate channels, we include in the sample only countries with relatively high political and civil liberties and that are at least partially free according to Freedom House.

Our final sample includes 62 countries for which observations are available over the 1984–2008 period and for which we construct five 5-year periods. Exploiting within-country variation in political persistence, we uncover a *negative* association between political persistence and economic growth, after controlling for country and time fixed effects. Moreover, sorting out countries according to the level of bureaucratic quality observed at the beginning of the sample period, we provide evidence of a differential relationship between countries with high and low red tape costs, such that political persistence is negatively associated with growth in high-red tape countries, but not in low-cost ones, consistently with the implications of our theoretical analysis.

Our empirical findings are *prima facie* at odds with the conventional wisdom of a negative relationship between political instability and economic growth. Most empirical contributions use data on revolutions, coups and assassinations or frequency of government changes to construct measures of socio-political instability and political uncertainty, generally finding a negative effect of instability on growth (see the survey by Carmignani, 2003 and, for a more recent contribution, Aisen and Veiga, 2013). Yet, a few papers point out that political instability bears a positive association with growth when it does not involve political regime switches or irregular government changes. For example, Faccio (2006) argues that government stability enhances growth in the case of irregular government changes, but is negatively associated with growth in the case of regular changes. More recently, Jong-A-Pin (2009) shows that, while instability of the political regime has negative effect on growth, within-regime political instability has a positive impact. Finally, in a recent study investigating the relationship between political regimes transitions and growth accelerations (along the lines of Hausmann et al., 2005); Jong-A-Pin and De Haan (2011) find that growth accelerations are less likely the longer a political regime (be it a democracy or an autocracy) has been in place. Though based on different methodologies and focusing on different dimensions of political stability, these results together lend support to the view that political persistence may be detrimental to growth. Our estimates corroborate these findings, as longer tenure of main political entities (political stability) is associated to lower growth. Furthermore, we show that the negative association between political persistence (i.e. stability) and growth is observed only in high red tape cost countries, while no robust correlation emerges when red tape costs are low.

Besides already cited contributions, our work can be related to the literature on the economics of corruption, although in our view political connections do not involve bribing or any illegal activity but provide easier access to information and simplified procedures, as we assume in our theoretical model (for a review of the literature on corruption, see Bardhan, 1997; Svensson, 2005). Recently, Harstad and Svensson (2011) developed a theoretical model where firms, instead of complying with regulation, can either bribe or lobby the government and study under which conditions firms decide to bribe or lobby and the effects of this choice on economic growth. Blackburn and Sarmah (2006) study a model where private agents can bribe bureaucrats in return for

[1] Several empirical contributions investigate the relevance of political connections for firms' performance. From a cross-country perspective, Faccio (2006) documents the widespread existence of political connections and that these connections significantly add to company values. Faccio et al. (2006) find that politically-connected firms are significantly more likely to be bailed out than similar non-connected firms. More importantly for our paper, Desai and Olofsgard (2011) find that politically influential firms encounter fewer administrative and regulatory burdens and invest and innovate less.

[2] Although in our simple theoretical model we consider a single politician, our argument is more general and may be extended to consider the persistence in power of the political elite as a whole. This is what we have in mind in the empirical part where, rather than focusing only on the turnover of the prime minister or the major party, we use an aggregate measure of the persistence in power of all main political entities, including politicians and political parties belonging to the winning coalition.