1 *Introduction*

Has India's political system aided its successful economic growth over the past fifteen years, or has India's rise occurred in spite of the political forces militating against economic growth? On the face of it, the picture of India's success being 'In Spite of the Gods,' to use Edward Luce's phrase, appears quite compelling (Luce 2008). Over the past sixty years since it gained independence from British rule, the Indian political system has changed almost as dramatically as its more-heralded economic system.

The principal political change has not been to India's democratic framework. That has remained intact. Rather, if one were to use a single word to describe the modern Indian political system it would have to be "fragmentation." After continuous rule at the Center and in most states by the Congress Party, today's political system finds a multitude of regional- and state-level political parties in power or in the position of kingmaker as tenuous coalition governments are assembled.[1]

The effects of this are easy to see in the political arena: virulent anti-incumbency tendencies and high electoral volatility, which in turn affects the quality of governance and types of public policies enjoyed by citizens.[2] At the national level (or Centre), the rise of regional parties and the increasingly inability of the 'national' parties such as the Congress and Bharatiya Janata Party (BJP) to compete all over the country has made coalition governments a fact of modern Indian political life.

[1] The fragmentation of the Indian political system is documented by Chhibber and Nooruddin (2000), and explained by Pradeep Chhibber and Kenneth Kollman (1998, 2004).

[2] Linden (2004) and Nooruddin and Chhibber (2008) focus on anti-incumbency and electoral volatility respectively. Chhibber and Nooruddin (2004) shows that Indian states characterized by multi-party competition provide lower levels of public services to citizens than those with robust two-party competition.

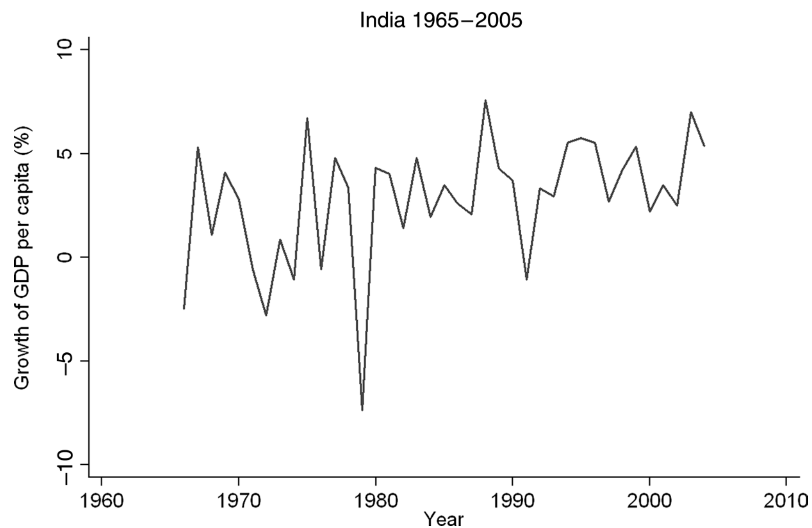

Figure 1.1 India's economy is doing better in recent years (source: World Bank 2006).

Even a brief review of the relevant scholarship in political science would suggest that the *economic* effects of such political fragmentation should be negative. Political instability is expect to cause domestic and international investors to flee a potentially chaotic situation. And coalition governments are thought to be hamstrung from providing deeper and more business-friendly economic policies. Yet, the opposite appears true (see Figure 1.1). Since 1991, when a balance-of-payments crisis and pressure from international lenders such as the International Monetary Fund (IMF) led to wide-ranging economic liberalization, India's economy has been growing rapidly. This successful economic performance, long overdue for India's immense poor majority, is puzzling in two important ways. First, the economic progress has occurred against the backdrop of minority and coalition national governments, increasing party fragmentation, and higher electoral volatility. Second, the economy has become more stable, with fewer and smaller fluctuations in its growth rate, even as it has been more exposed to the vagaries of international trade and finance.

This book seeks to resolve these two puzzles by focusing on a hitherto-ignored question in comparative and international political economy: why do some countries experience more volatility in their

growth?[3] This issue is central to our understanding of the dynamics of national economic performance, and holds the key to clarifying how political institutions affect economic growth. Further, in tackling this question, the book will also shed light on other important questions in comparative political economy, such as why do some countries attract more foreign direct investment than others? Why are some more prone to destabilizing capital flight? Why are some able to encourage citizens to save more? Each of these questions has received considerable attention from political scientists and economists; this book provides an integrated framework for understanding these diverse phenomena, which affect the lives of billions of people around the world.

Good national economic performance, I will argue, is the consequence of having the right configuration of national political institutions. Specifically, I will show that countries in which policymaking authority is diffused across political institutions controlled by actors responsive to different societal constituencies are better able to make credible commitments to long-term policy stability. These commitments, in turn, engender more stable investment patterns by private economic actors, and make countries less susceptible to capital flight as investors are less likely to flee at the first sign of trouble. Taken together, such behavior by private actors leads to more stable, and higher, economic growth over the long term.

That political institutions affect national economic performance and investment behavior is not a novel argument. Over the past twenty years, even economists have come to accept this proposition, with some of the more prominent recent contributions by economists to the study of economic growth placing historical and current political institutions at the center of their investigations. Similarly, scholars have studied the effect of democratic institutions on foreign direct investment flows and on the incidence and severity of crises. So, what's new here?

The argument proffered expands our understanding of the politics of national economic performance in at least four distinct ways. First,

[3] Growth-rate volatility might be defined as the relative rate at which growth rates increase and decrease. A conventional measure of volatility is the standard deviation of growth rates over some period of time. I am certainly not the first to study growth-rate volatility and the past decade has seen scholars begin to focus on this important topic. Yet, compared to the vast literature seeking to explain variations in *average* growth rate, work on *volatility* is but a drop in the ocean.

the empirical implications of the argument, as will be detailed below, will strike many readers as counter-intuitive and potentially controversial. Unlike other scholars who emphasize the importance of "state strength" or "political will," I come not to bury "gridlock" but to praise it. Here, separation-of-powers institutions in which political leaders cannot make drastic policy changes unilaterally and arbitrarily are celebrated for providing private economic actors credible information about future policy stability. Second, I seek to bring "society" back into institutional analyses of economic performance by emphasizing the importance of political parties in representing diverse societal preferences within the formal halls of power. This enriches how we think about political institutions, and moves away from overly abstract formulations of institutions in which a single policymaker responds to a single median voter in society. Rather, I argue, politics must be understood as a competition over power in which policy compromise is to be valued rather than bemoaned. Third, I identify a diverse set of empirical implications of the causal story in order to tease out the causal mechanisms at work here. Prior studies typically stop short of doing so, and as I will try to convince the reader, existing arguments linking political institutions such as democracy with economic outcomes are under-specified so that empirical correlations are consistent with several alternative interpretations of the underlying causal mechanisms. Finally, the framework developed crosses boundaries between comparative and international political economy. For modern developing countries, the dynamics of economic growth are intimately connected to those of international capital flows. International business actors must choose where to invest their capital, and this decision is conditioned in part on the political framework in place and the expected stability of the rules-of-the-game in that country. The argument thus privileges policy stability over its content. I am not sure if policy matters, or even if we know what policies are best, but a stable policy environment definitely matters, and diffuse policymaking authority is the best way to get policy stability. If there are good policies out there, the coalition form of diffuse authority is the safest way to get them. By explaining where such stability comes from, my framework can thus make explicit predictions, which I test cross-nationally, about foreign direct investment and capital flight patterns.

The remainder of this introductory chapter is organized as follows. In the next section, I establish more fully the empirical puzzles

motivating this book, and explain why understanding volatility is intimately connected to understanding growth. Then I provide a synopsis of the theoretical framework developed here, summarize the main empirical results, and contrast my argument with previous research. (A fuller explication of the framework, as well as a more complete consideration of prominent alternative political and economic explanations, is reserved for the next chapter.) The final section highlights the book's primary theoretical contributions, its normative and policy implications, and concludes with a road-map to the rest of the book.

Puzzles of national economic performance

In 1999, in the aftermath of the Mexican "tequila" crisis and the East Asian financial crisis, the International Monetary Fund (IMF) published its annual *World Economic Outlook* focusing on the importance of maintaining macroeconomic stability at low inflation. In it, the IMF concluded "the severe macroeconomic crises in Latin America during the 1980s [had] brought into sharp relief the need for deep-seated reforms to restore fiscal and monetary discipline and increase reliance on market mechanisms for resource allocation" (International Monetary Fund 1999: 52). Argentina was hailed in this report as "one of the countries where [such] structural reforms have advanced the most," the success of which was evident in the "expansion of real GDP by 5.35 per cent a year on average between 1990 and 1995," despite the severity of the 1995 "tequila" crisis (International Monetary Fund 1999, 52-53).

Three years later, the IMF's assessment appeared recklessly optimistic and inaccurate. The Argentine economy collapsed between 2000 and 2002, with devastating consequences for the population. The economic crises led to widespread unemployment, and underemployment, forcing millions of people into poverty. At the height of the crisis, on September 22, 2002, the *New York Times* wrote, "Argentina's jobless rate has risen above 20 per cent and the value of the peso has fallen by more than 70 per cent against the dollar. Homelessness is on the rise, and nearly *half* the country's 36 million people now live in poverty." The *Times* article went on to tell of how previously employed residents of Buenos Aires were turned into scavengers, digging through garbage to find items to recycle for money or food to eat. Another *Times* article told of old-age pensioners who

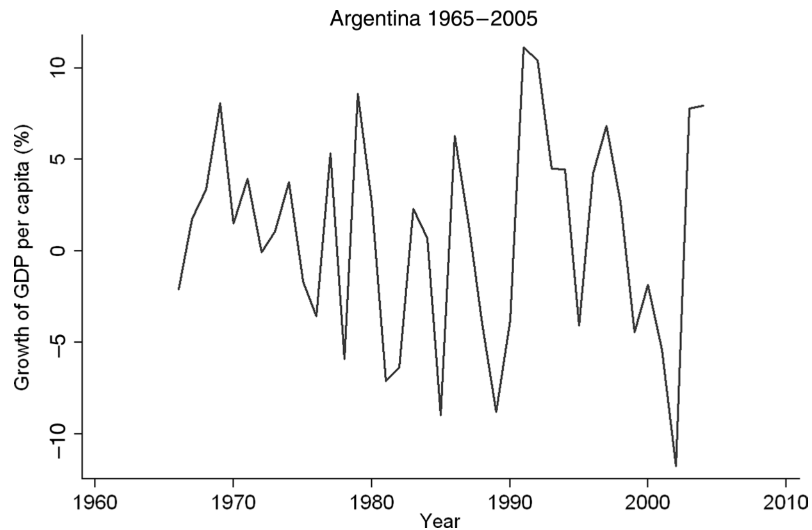

Figure 1.2 Argentina has always had extreme volatility in its growth (source: World Bank 2006).

turned to prostitution in Buenos Aires because their savings had been wiped out.

Today, Argentina's economy is enjoying again high growth. But the events of the past fifteen years in Argentina beg two questions: should we have been surprised by the collapse in 2001 and should we expect the good times to continue indefinitely now? A brief look at Argentina's growth patterns over the past forty years suggests that the answer to both questions is no. If anything the high rates of crises and consistently high levels of growth-rate volatility in Argentina's past caution us that the current good growth is soon to be followed by a collapse, and indeed the most recent indications are that this is precisely what is coming to pass.

Such horror stories of sudden unpredictable economic collapse are not unique to Argentina, of course. At the height of the Asian financial crisis, "World Bank assessments warned that the economic fallout could wipe out all the progress against poverty these countries had achieved during the past 25 years" (USAID 2000: 2). Korea, for instance, experienced an increase in the country's poor "from 7.5 per cent [of the population] just before the crisis (first quarter of 1997) to a peak of 22.9 per cent in the third quarter of 1998" (Atinc 2002: 123).

In Indonesia, between ten and twelve million people were forced into poverty within a year of the crisis (Atinc 2002). As in Argentina a few years later, the social crisis in East Asia was exacerbated by reductions in public spending on essential services such as health care and education, and the fall in household incomes as people lost their jobs and prices rose (Newfarmer 1998). The effects could be long-lasting. The short-term consequences in East Asia were higher hunger and malnutrition, a surge in infectious disease, and a drop in school enrollment rates. The long-term consequences are yet to be determined, but the World Bank warned that poor health and increased malnutrition would hurt worker productivity, reducing future growth prospects. Young children were likely to suffer most, with the worst-hit facing stunted growth and poor cognitive development.

The negative consequences of volatility can be thought of as reversing the positive effects of development. Indeed, World Bank economists Jorge Arbache and John Page have argued that volatility in growth had erased the gains of positive growth between 1975 and 2005 resulting from improved policy and governance in many sub-Saharan African countries. Holding all other factors steady, if African economies could have eliminated periodic collapses in growth, they would have grown at 1.7 percent a year per capita, rather than the 0.7 percent they actually realized. This might not seem like a lot, but an extra percentage point of average annual growth over the period would have added 30 percent to the region's GDP (Gross Domestic Product) (Arbache and Page 2007: 11). Sirimaneetham and Temple reach a similar conclusion, finding in their data that "a 1 standard deviation improvement in stability translates into an annual growth rate that is 0.5–0.7 percentage point higher over 30 years" (2009: 463). Averaged over the period, a 0.7 percentage point increase would result in a 23 percent higher GDP per capita.

Sirimaneetham and Temple's analysis of volatility's effects on growth rates makes two points relevant to the broader discussion on the importance of focusing on volatility as a distinct dimension of countries' national economic performance. First, macroeconomic stability dominates several other possibilities for identifying distinct growth regimes; and, second, instability appears to form a "binding constraint" on growth for countries in the less stable growth regime, by reducing the effectiveness of technology and innovation, and of investment (Sirimaneetham and Temple 2009: 475).

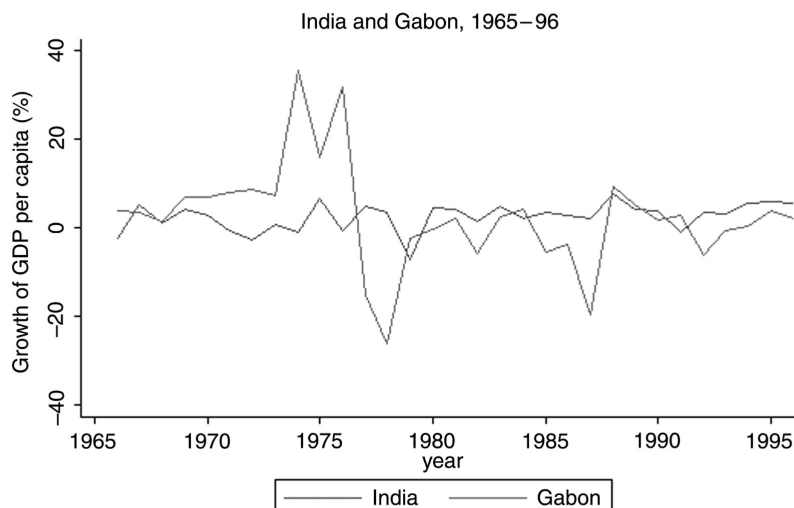

Figure 1.3 India and Gabon, 1965–96 (source: World Bank 2006).

Not all countries experience such destabilizing volatility, of course, and some countries manage to extract themselves over time from the conditions that cause it. Such variation in growth-rate volatility has received relatively little attention from political scientists, most of whom have focused instead on explaining variation in average long-term growth rates. But the almost-exclusive attention to growth averages has masked important differences in national economic performance.

Consider the different growth trajectories of India and Gabon from 1965 to 1996, just prior to India's recent rapid and sustained economic growth.

The choice of these two countries is not accidental. Both India and Gabon are developing societies but with fairly different growth trajectories. Over the thirty-year period summarized by Figure 1.3, India's average growth rate was 2.46 percent; Gabon's was 2.47 percent. That is, the two countries were indistinguishable in terms of the average growth rates they managed to achieve. However, their average volatilities are very different: while India never reached the extremely high growth rates experienced by Gabon in the early 1970s, India grew at a fairly stable rate while Gabon's high rates of growth were quickly

followed by several years of devastating negative growth. The discovery of oil in the early 1970s generated tremendous income so that Gabon's per capita income doubled from $4,168 in 1973 to $8,508 in 1976. But the fall in oil prices in the mid-1970s devastated Gabon's economy so that by 1978 the per capita income had fallen 37 percent to $5,322. Per capita incomes in Gabon have fallen ever since as negative growth persisted well into the 1980s. India, by contrast, chugged along steadily at what some observers derisively termed the "Hindu rate of growth" until its recent sustained high growth.

Lest one wonder about the comparability of India and Gabon, perhaps one more example will serve to convince readers of needing to consider volatility too. Angola and Namibia, neighbors in Africa's southern cone, are both resource-rich sub-Saharan countries, albeit with different recent political histories. Angola has just ended a devastating civil war that spanned three decades, while Namibia is near the end of its second decade of relatively successful democratic self-rule. Did this difference in political past affect the economy? By one reckoning, no. If one considers only the average growth rate of both countries between 1990 and 2005, there is virtually no difference between the two countries with both showing limited evidence of growth.[4] But even a brief glance at Figure 1.4 reveals that this is misleading.

The negative effects of Angola's civil wars are quite evident in the crippling economic collapse between 1987 and 1994, in which economic growth rates never got over zero, and fell as low as negative 27 percent in 1993. Angola certainly enjoyed more years of high growth than Namibia, largely due to rising oil prices in this decade, which leads to the apparent equivalent average performance over the past twenty-five years, but one would be hard-pressed to argue that the two countries truly had no difference in economic performance during this period. Once again, looking simply at average growth masks more than it reveals.

Stepping back from the experiences of these countries to a more global perspective reveals interesting and hitherto unexplained variation in national economic performance. Figure 1.5 plots all countries

[4] Angola's average growth in GDP per capita is 1.68 percent while Namibia's average growth rate during that period is 1.32 percent.

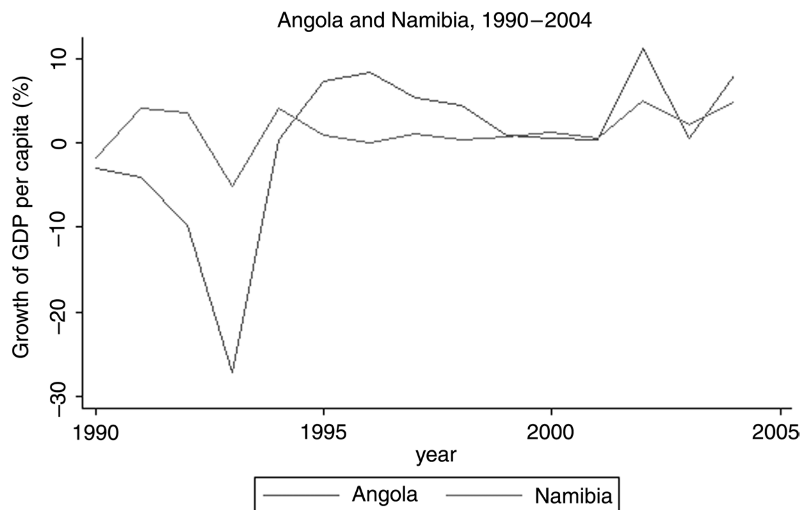

Figure 1.4 Slow growth on average in both, but Angola and Namibia had different growth trajectories nevertheless (source: World Bank 2006).

for which data are available from the World Bank in terms of their average growth rate and the volatility of that growth rate. To ease comprehension, I indicate the world averages on each axis by drawing a straight line at that point.

Countries in the lower right-hand quadrant of Figure 1.5 are those that have achieved growth rates higher than the world average over the same period but at lower-than-average levels of volatility. One might term these "sustained high-growth" countries. Those in the upper right-hand quadrant have had high average growth but at very high rates of volatility too ("unstably successful"). In the lower left-hand quadrant are states with lower than average growth, but with low instability too ("stable underperformers"). And, finally, in the upper left-hand quadrant are those stuck in a low-growth high-instability equilibrium from which it is extremely difficult to emerge ("unstable poor performers").

While most countries fortunately never experience crises on the scale experienced by the East Asian states in 1997 or by Argentina in 2002 or Angola in the early 1990s, most developing countries do go through recessions and slight crises at different points in their history.

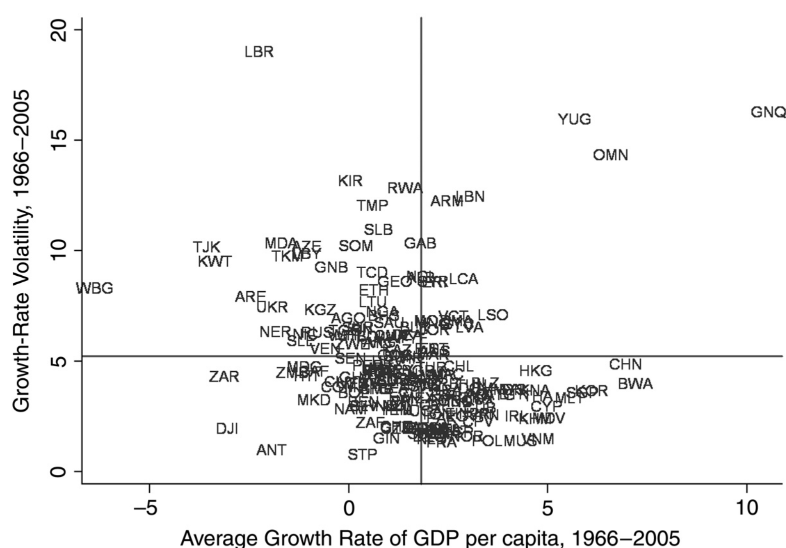

Figure 1.5 Global variation in national economic performance, 1966–2005 (source: author's calculations from World Bank 2006).

For instance, India's growth trajectory over the first fifty years after its republic can be divided into three epochs. The first was from 1950 to 1964 and reflected the initial successes of Nehru's five-year plans and the industrial revolution. An economic crisis in 1965 led to a first set of reforms. From 1967 to 1977, India's economy was more volatile than ever before, and for the first time in its history, India underwent successive years of negative growth. As anyone familiar with India's history knows, the bookend of this period was Indira Gandhi's declaration of Emergency, followed by the replacement of the Congress Party at India's helm in New Delhi. Finally, the 1980s were a period of growth in which India had a steady growth rate of around 3 percent per year. India's economy then experienced significant reform and liberalization in 1991 and the 1990s provided a mixed record with higher rates of growth although never approaching the levels previously seen in China or the East Asian Tigers.

These periods of India's growth trajectory do not differ simply in their average growth levels; they differ also in the degree of volatility. If one divides the forty-year period represented in Figure 1.1 into two,

using the end of Emergency and Congress Rule in 1978 as a convenient breakpoint, India's growth-rate volatility in the first period, as measured by the standard deviation of the growth rate over that period, is 3.09 percent. In the second period, between 1980[5] and 2004 (the most recent date for which data is available), the standard deviation of the growth rate is just 1.87 percent.[6]

India is by no means an exception in exhibiting such cross-temporal variation in growth rate. Rather, as Lant Pritchett (2000) clarifies, such differences in growth rates over time within a country are quite common and quite large. "Among the developing countries the absolute value of the shift in growth rates averages 3.4 percentage points ... Growth rates in 55 of the 111 countries either decelerated or accelerated more than 3 percentage points within the period [surveyed]" (Pritchett 2000: 227). Indeed, such fluctuations cause Pritchett to conclude,

> [the] fixation on differences in long-run (even possibly steady-state) differences in growth in the theoretical and empirical research explaining growth has led to an underestimation of the importance of the *instability* and *volatility* in growth rates ... Is explaining Brazil's "growth" explaining the 4.2 percent growth from 1965 to 1980 or explaining the stagnation from 1980 to 1992 (actually a slight fall of −0.2 percent) or explaining Brazil's average growth percent from 1960 – 92 of 3.14? (2000: 222).

To be clear, Pritchett is talking about variation in the levels of growth over different periods of a single country's history rather than variations in the volatility of growth over different periods, a subtle but crucial distinction. However, his larger point is important: to understand growth we must pay attention to fluctuations within countries as well as across them (see also Agenor *et al.* 2000).

[5] As with most developing countries, India had an economic crisis in 1979 as a result of the second OPEC price hike. This led to the downfall of the Janata Party government and the return to power by Indira Gandhi. I exclude this year (1979) from the analysis because it is an outlier.

[6] The average growth rates over these two periods were 1.65 percent and 3.79 percent respectively. Data are from the World Bank (2006: CD-Rom).

Growth-rate volatility, of which crises are the most dramatic instances, is under-studied in political science, but as the cases of East Asia and Argentina demonstrate, the human effects of extreme volatility make understanding its political determinants a central question for comparative and international political economy.

The credible constraints argument summarized

Previous research on political institutions and economic growth has found mixed or no support for the claim that democracy generates higher average levels of economic growth (e.g., Przeworski *et al.* 2000). These weak results have arisen in part because, in seeking to explain cross-country variation in growth rates, $V_i(d(Y))$ (where i indexes countries and Y is income), as a result of cross-national variation in (the degree of) democracy, political science has generally ignored cross-national and cross-temporal variation in growth-rate volatility, $V_{it}(V(d(Y)))$ (where i indexes country and t indexes time), thereby missing an area of economic performance both critically important to long-term growth and more directly susceptible to political factors.[7] These, in turn, extend deeper than merely the degree of democracy in the abstract to its institutional and structural specifics. However, political science has as yet allocated too little effort either to explaining cross-national and cross-temporal variation in growth-rate volatility or to elaborating the specific institutional and structural features of concrete democratic regimes that underlie such explanations.

In this book, I argue that governments' inability to commit credibly to present and future policies strongly contributes to growth-rate volatility. Specifically, governments' inability to commit credibly to future and current policies, i.e., to policy stability, (1) induces investors to avoid long-term commitments in and to their investment projects,

[7] Przeworski *et al.* (2000) do find that democracies are more consistent in their growth performance than non-democracies. That is, non-democracies produce the miracles and failures, whereas performance amongst democracies is closer to the mean. Note though that this finding says nothing about growth-rate volatility *within* a country's history, only that growth performances among non-democracies are more heterogeneous than among democracies. This is an interesting point, but conceptually distinct from the one I'm making here. I thank an anonymous reviewer for this point.

and (2) makes them, because of the nature of their investments and because they lack confidence and/or certainty regarding future government policy, more likely to abandon the country at smaller signs of economic trouble. The ability to make such volatility-dampening and growth-enhancing credible commitments is rooted in a specific configuration of state institutions that I identify. Specifically, I contend that the diffusion of policymaking authority to multiple actors with accountability to different constituencies lowers the average level of growth-rate volatility a country experiences, while increasing stable investment flows and discouraging capital flight. This diffusion of policymaking authority across different policymakers with different accountabilities provides a set of *credible constraints* on an executive's ability to change policy autonomously (and potentially arbitrarily). Such constraints from potentially arbitrary policy and from policy variability bolster confidence amongst private economic actors. The investor confidence engendered in countries with such institutions, in turn, fosters longer-term, more stable investment that helps those countries withstand temporary shocks, preventing them from developing into the full-blown crises that are more likely to emerge in countries lacking such institutions as panicked investors flee the likely unstable and/or poor policy-environment in the aftermath of shocks. Thus, the inability of governments lacking the credible constraints of diffuse policymaking authority and accountability to commit credibly to present and future policies induces savings and investment volatility and, thereby, growth-rate volatility.

I test various empirical implications of this argument using two sets of data. The primary tests are conducted using cross-national political and economic data, primarily from the World Bank but supplemented by other sources where necessary. I find that states with diffusion of policymaking authority resulting from divided or minority governments, and coalition governments – each of which entails diffusion of policymaking authority across actors accountable to differing constituencies – have lower growth-rate volatility, *ceteris paribus*. On the other hand, the degree of democracy, per se, and other aspects of democratic regimes less connected to the diffusion of authority across differing-constituency representatives are not, or less, correlated. Furthermore, I show that these correlations of output-growth volatility and certain democratic institutions do in fact arise via the savings-and-investment-volatility channel as argued.

Advantageously, the *credible constraints* framework can also be enriched to contain case-specific detail on the nature and identity of key policymakers, moving beyond the standard (readily available) quantitative measures of government type, its divided or minority status, and its monetary institutions, to discuss more precisely the experiences of specific cases with their particular diffusion of authority. I demonstrate this advantage in a second set of analyses using India as an empirical test-bed for these ideas. India has experienced very high growth for the past fifteen years, which is long overdue given its previous record of slow growth with occasional bouts of volatility. To some extent, this is puzzling given economists' explanations of growth stability: in essence, India's most stable growth has been achieved at a time when its exposure to the vagaries of international trade and financial flows are at their highest. Further, contrary to the expectations derived from existing explanations but consistent with the *credible constraints* framework offered here, India's stable and high growth rates have been achieved under sustained coalition governments at the Center, while its less stable and lower growth rates were under the watch of single-party majority governments. I also leverage the inter-state variation within India to shed light on my argument since India's states vary both in their economic performance and the diffusion of policymaking authority, while allowing me to hold constant national-level political institutions and economic policies.

In a final empirical evaluation of the theoretical framework, I conduct four brief case studies of two developing states (Brazil and Botswana) and two developed democracies (Spain and Italy). The case studies demonstrate the utility of the framework for explaining national economic performance in varied settings, and induce interesting directions for future research.

The book's argument thus advances our understanding of growth-rate volatility by specifying the institutional and economic policies that cause, and the mechanism by which they cause, growth-rate volatility, and, thereby, shape national economic performance. Four existing political explanations of growth-rate volatility offer important insights into some of the different roles democracy may play in mitigating volatility. First, Siddharth Chandra and Nita Rudra argue that institutional diversification, which they associate with democracy, leads to less volatile policy outputs through what they call "partisan mutual

adjustment" and therefore lower volatility: an institutional-portfolio-diversification argument (Chandra and Rudra 2008). Next, Dani Rodrik (1998b, 2000) argues that democracies exhibit higher levels of social cooperation and compromise in the face of exogenous shocks, which allows them to navigate and ameliorate the effects of these shocks: a constituency-diversification-through-compromise argument. Third, Dennis Quinn and John Woolley argue that, in democracies, risk-averse publics are better able to constrain their more risk-acceptant leaders in democracies from making risky policies, their emphasized source of growth-rate volatility: an-assumed-risk-averse-principal-constrains-an-assumed-risk-acceptant-agent argument (Quinn and Woolley 2001). Finally, Acemoglu *et al.* (2003b) argue that societies in which executives are constrained, again more likely in democracies, have stronger property rights protections and stronger economic institutions, and therefore lower volatility: a constrained-executive argument.

While important, making contributions that have influenced my thinking here, these arguments are limited theoretically because they make strong auxiliary assumptions that may not always hold (Quinn and Woolley) and/or because they do not specify clearly what political institutions should matter for growth-rate volatility (Chandra and Rudra), what aspects or types of democracy best produce the argued effect (Rodrik; Acemoglu, Robinson, and Johnson), or what economic policies are "risky" and volatility-inducing (Chandra and Rudra; Rodrik; Quinn and Woolley). Empirically, the first three studies all use the same Freedom House index of political and civil liberties to measure democracy, preventing one from distinguishing among these three possible mechanisms by which regime type could relate to volatility and from exploring what specific aspects of regime type produce that relationship. Acemoglu *et al.* (2003b) use the Polity measure of "executive constraints," a closer match to their argument, except that we cannot be sure what types of constraints matter, or how this effect differs from the general 'democratic' effect since they do not include a control for the latter. This book aims to advance comparative political economy of national economic performance research by specifying the configuration of government institutions – namely the diffusion of policymaking authority to multiple policymakers accountable to different constituencies – that makes policy change more difficult and policy stability more credible. Further, where policy change is required

to deal with economic shocks, diffusion of policymaking authority requires policymakers to compromise with each other if they are to enact policy. Thus, the analysis here encompasses both Chandra and Rudra's (2008) institutional-diversification argument and Rodrik's (2000) social-compromise thesis, clarifying the specific institutional sources of these effects and the mechanisms by which they obtain. Likewise, since separation of powers occurs more commonly in democracies than non-democracies, the framework can also accommodate Quinn and Woolley's (2001) risk-averse public/risk-acceptant-policymakers argument and Acemoglu *et al.* (2003b) constrained-executive argument, again supplying sufficient specificity to compare effects within and across democratic and non-democratic cases. The effects will, for example, neither obtain in all democracies nor fail to obtain in all non-democracies to the same degree because the effects propagate through the nature of the division of policymaking authority and depend on the nature and on the structure and openness of the domestic economy. These more precise theoretical distinctions and comparisons, moreover, enable empirical exploration that can also distinguish between differing arguments for broader correlations of democracy and growth-rate volatility. Finally, unlike the extant theories, which do not explore intermediate connections from government policy to volatility, my theory explicitly links these specific democratic institutions and economic contexts to growth-rate volatility through cross-national savings and investment patterns, and to business decisions to engage in new ventures, so its empirics gain additional leverage explicitly testing that linkage.

Theoretical contributions and policy implications

The argument developed in this book contributes to two longstanding questions in political science. The first of these debates concerns the relationship of the state to society. I incorporate insights from statists and pluralists by suggesting that political scientists can gain from considering how societal interests interact with institutional configurations to enable policy change. Recent political economy of development research on the determinants of cross-national economic growth focuses exclusively on institutional factors (such as democracy), leaving aside questions of societal interests and how political

institutions mediate these interests. Indeed, to the extent that societal factions enter such analyses, the goal is to find ways to insulate technocrat-policymakers from the corrupting influence of such special interests. The second theoretical debate to which I contribute concerns the sources of policy credibility. The core argument made here, i.e., that governments can gain credibility via "gridlock", is likely to be controversial given that scholars have argued for some time that such gridlock hinders developing countries' abilities to make needed economic reforms. The conventional wisdom is that economic reforms, such as privatization or liberalization, require "strong" governments with political "will." While this may in fact be true, my consideration of credibility raises the question of why such reforms by "strong" "willful" governments are considered credible by others and suggests insights for thinking about the success and failure of economic reforms as well as the scope of the reforms pursued.

These ideas have important policy implications, especially as they bear on the design of political institutions. For some time now, it has been conventional wisdom to encourage developing countries to bolster judicial independence, and to create independent central banks. These recommendations accord with the core argument of this book, but my research suggests we must go further and encourage developing countries to create political institutions that require the incorporation of diverse interests and societal preferences in the policymaking process. Further, the mechanism via which these interests should be represented is the political party, a political institution that has been ignored in most recent research on economic growth. But, as Samuel Huntington argued in his seminal book on *Political Order in Changing Societies*, political parties play a vital role in channeling public opinion into the policy arena. There exists a heated debate in some circles as to whether ethnic, cultural, and linguistic heterogeneity hinders growth; certainly, it might, but especially if some groups are excluded from the halls of power and have no opportunities for expressing themselves or for having their preferences reflected in policy. Rather than create strong executives as is being done throughout the developing world (presidential governments are the most frequently created form of new democracy), this book suggests we should heed the sage advice of James Madison in *Federalist 10*: "where there is a consciousness of unjust or dishonorable purposes, communication is always checked by distrust in proportion to the number whose concurrence is necessary"

(Hamilton *et al.* 1987 [1788]). In other words, the original insights of the framers of the US Constitution to require a system of checks and balances were sound, and must be followed as we create new institutions in new democracies. To this I will add one caveat as the book progresses: it is better to have systems that generate coalition governments than those that generate divided government, i.e., to have parliamentary democracies than to have presidential systems. In the former, I shall argue, and the evidence will show, the survival of the government depends on the cooperation of the various members of the coalition, which dynamic enables cooperation over, and the passage of, policies when necessary. In divided presidential systems, by contrast, the executive and legislature survive independently of each other, nullifying incentives for cooperation, and making policy gridlock possible even when it is imperative for the government to act. Such problems are especially likely when political parties are young, and leaders are still developing the rules and norms that will guide their behavior in office.

The next chapter situates this argument in the broader literature about how politics might affect national economic performance, and develops its underlying causal logic in more detail. The chapter concludes by identifying a set of empirically-verifiable propositions suggested by the theoretical framework. Chapter 3 takes the main implications about economic growth and volatility to a cross-national time-series data set of all developing countries from 1965 to 2004, and finds strong support in their favor. This chapter also utilizes matching techniques to address concerns of endogeneity. Chapter 4 uses the same cross-national data, as well as a World Bank survey of firms across the world, to test the implied causal mechanisms of the theory. I find that firms located in countries governed by parliamentary coalitions are less likely to perceive policy uncertainty to be a major obstacle to their businesses, and more likely to consider opening a new establishment in the near future. Similarly, such countries generate higher rates of private saving and induce lower levels of capital flight. Taken together, these results suggest that the basic logic of the theory is sound, and bolster confidence in the findings reported in the previous chapter.

Having demonstrated the strength of the argument cross-nationally, Chapter 5 applies the theoretical framework to the Indian case. India is today concerned to be one of the world's foremost economic engines, and is increasingly tipped to be an economic superpower in the coming

century. This heady optimism is in sharp contrast to the pessimism that characterized most observers of India's "Hindu rate of growth" for the first thirty years after independence. Interestingly, the rapid increase in growth coincides with the fragmentation of the Indian political system and, increasingly, coalition politics. I argue that this is not a coincidence, and utilize variation in business attitudes and coalition governments across India's states to support the claim. Chapter 6 applies the logic to four different cases, demonstrating the flexibility of the argument as it helps explain the persistently high volatility of Brazil, and the comparative economic success of Botswana. The argument also works in developed democracies, as shown by case studies of Spain and Italy in the post-1945 period. The book concludes in Chapter 7 by considering possible extensions of the framework, as well as the theoretical and policy implications of my findings.