7 *Conclusion*

India began the twentieth century as the jewel in the crown of the British empire. A hundred years later it begins the new millennium as a success story of economic growth in the developing world. Yet while India appears to have made this transition successfully, the challenges to its continued success are considerable and daunting (Bardhan 2009). Moreover, that many of its fellow former colonies in the developing world remain mired in what seems at times to be inescapable poverty, the stakes for understanding why some countries are able to enjoy better economic performance than others are apparent. While government programs can and do go a long way towards alleviating the suffering caused by poor economic conditions, generating sustainable and inclusive economic growth is possibly the surest way of doing so.

The challenges of economic development are made more difficult by a second normative goal for developing countries: developing democratic institutions that allow citizens to participate in the policymaking process by choosing their own leaders. The past fifty years have seen democracy spread across the globe, at least as a principle accepted by most people (Inglehart and Welzel 2005), and, despite reversals in democratic freedoms in some countries, the fact remains that more people live today in democratic countries than did in 1950. This increase in democracy globally is welcome in its own right, but the twin concerns of political and economic well-being raise an question of obvious pertinence: does democracy help or hurt national economic performance? If democracy increases economic growth, then we have yet another reason to encourage the adoption of democratic norms and principles in developing countries and to shout down defenses of dictatorial rule on the grounds of economic expediency. If, on the other hand, democracy is found to retard economic development, stronger normative justifications for democracy in poor countries must be developed, and discussions of the appropriate "sequencing" of such reforms must return to the center of political science conversations. Finally, should

democracy be found to have no effect on national economic performance, the case for democracy remains strong on normative grounds but is slightly weakened on more instrumental bases.

The relationship between democratic political institutions and economic growth has therefore been the focus of much recent research in political science, but the results have been equivocal at best. Przeworski *et al.* (2000) find little evidence that democracy aids growth, a conclusion borne out by a recent meta-analysis of multiple studies on the topic (Doucouliagos and Ulubasoglu 2008). Even more troubling for pro-democracy arguments, Mulligan *et al.* (2004) find no evidence of any systematic differences in the types of public policies made by democracies and non-democracies. And Ross (2006) concludes that democracy makes no material difference for the lives of the poor.

This book offers a different perspective on the relationship between politics and economic development. It does so by broadening the investigation to focus not only on the level of economic growth enjoyed by a country, but also the stability of that growth. More volatile economic growth has been found to hurt long-term economic growth prospects (Ramey and Ramey 1995, Sirimaneetham and Temple 2009), and it can have devastating consequences for those on the lowest rung of the economic ladder. Analytically the joint focus on volatility and level of economic growth allows me to distinguish between countries that might otherwise appear to be quite similar, and to build on a recent literature that treats growth-rate volatility as an important dependent variable in its own right (Chandra and Rudra 2008; Mobarak 2005; Quinn and Woolley 2001; Rodrik 1998b, 2000).

Given limited or mixed evidence about differences in policymaking across regime types (Mulligan *et al.* 2004) or for the effects of policy choices on growth outcomes (Acemoglu *et al.* 2003b; Easterly 2005, Fatas and Mihov 2005), I argue that cross-national variation in economic growth and volatility, i.e., in national economic performance, must be explained by understanding the behavior of private economic agents in developing countries. Specifically, where governments are unable to commit credibly to long-term policy stability, private economic agents engage in short-term and more liquid forms of investment, which allow them to withdraw their capital at the first signs of trouble. This means that longer-term investment opportunities vital to economic development are foregone because of the risks associated with policy uncertainty, and the economy is deprived of

valuable capital and made vulnerable to capital flight. Contrariwise, when governments are able to make credible commitments, economic agents are less likely to perceive policy uncertainty to be an obstacle to the conduct and growth of their businesses, more likely to save and invest their income, less likely to engage in capital flight, and more likely to invest in innovation. In turn, these actions generate higher and more stable economic growth.

The "credible constraints" theoretical framework builds on a vibrant literature in economics on the importance of government credibility for investor behavior. But what makes some countries more credible than others? Rather than rely on "expert" assessments of country credibility, which at any rate describe rather than explain cross-national variation in credibility, I offer a theory of credibility rooted in the relationship between political institutions and societal constituencies. In diverse democratic societies, control over policymaking authority is contested, leading to the possibility of policy fluctuations (and therefore lower credibility of future policy stability) as different groups come to power. In non-democratic societies, leaders face a different version of the same problem: given that they can unilaterally change policy, how do they convince investors that they will not do so?

Theories of credibility developed in the context of the OECD states have typically emphasized the delegation of policymaking authority from partisan political figures to non-partisan technocrats in bureaucracies. Central bank independence is perhaps the most well-studied of such mechanisms, though judicial independence is a close second. In both cases, actors independent of politicians and insulated from the whims and fancies of voters have a say in policymaking. Since these actors have longer time-horizons than politicians, their participation in the policymaking process increases expectations of long-term policy stability and therefore bolsters investor confidence (Cukierman *et al.* 1992, Henisz 2002, 2004).

An alternative source of credible commitments to policy stability arises from patterns of party competition within political institutions. Political parties compete for power by differentiating themselves on policy positions. When a single party controls all the levers of the legislative process, it is better able to enact policies closer to its ideal point. The resulting policy might in fact be the preferred outcome for economic agents too (for instance, if the government in question favors a business-friendly policy regime), but the government can not guarantee

that future governments will not reverse course should the opposition win. In this case, even if economic agents respond by investing in the country, they will remain wary of future policy change, and therefore forgo more irreversible investments.

In other situations, however, no one party controls the policymaking process fully; in this case, where policymaking authority is diffused across multiple actors, each controlled by a different party that in turn is accountable to a different societal constituency and therefore with a different ideal point on policy, policy change becomes more difficult as the set of policies on which both (or all) parties with a say in the policymaking process agree shrinks. In presidential systems, this situation arises when different political parties control the executive and legislative branches of government, a situation commonly called "divided government." In parliamentary systems, the situation arises when no one party secures a majority of seats in the legislature, forcing the largest party either to form a "coalition" government, or to rule as a "minority" government with support from outside the government. Divided presidential and coalition or minority parliamentary systems both result in smaller win-sets for policy change, but with important differences. In divided presidentialism, the survival of each branch of government is independent of the other, giving neither party much incentive to cooperate with the other. This leads to "gridlock." In coalition or minority parliamentary systems, by comparison, the survival of all parties in the legislature is contingent on the survival of the government; the government can therefore get policy enacted by threatening a vote of confidence, the failure of which would dissolve parliament and lead to fresh elections. The caveat however is that the government must compromise its preferred policy positions to garner enough support from other parties that passing the legislation is preferred to taking one's chances at the polls in new elections. Thus, the dynamics of parliamentarism generate incentives for "policy compromise" rather than gridlock when coalition or minority governments prevail. The broad implications of this analysis, I argue in the book, are that coalition and minority parliamentary governments are best suited to convince economic agents that policy change will be incremental and based on shared consensus (and therefore stable). To the extent that economic agents are risk-averse, such policy stability should encourage them to invest more in the economy, be less likely to flee at

the first sign of trouble, and therefore generate higher and more stable levels of economic growth for the country.

The theoretical framework thus tackles a fundamental question in comparative political economy: how does politics affect national economic performance? Building on well-established theories about the importance of democracy on the one hand and about the importance of policy credibility on the other, I offer a novel and somewhat counterintuitive answer: governments forced to compromise with political opponents are most likely to generate good national economic performance. This answer flies in the face of previous scholarship that has endorsed "strong" governments that push through painful economic reforms at the expense possibly of political freedoms and competition as exemplified by the old dictatorial apologia, "You can't make an omelette without breaking a few eggs."

The core insight also finds support in the literature on ethnic conflict that has long advocated the development of power-sharing institutions that force erstwhile opponents to compromise with each other in order to govern. These arguments have been applied both to the governance of ethnically-divided societies (Horowitz 1991), to quelling ethnic violence (Varshney 2002), and to the settlement of violent internal conflicts (Hartzell and Hoddie 2007). Further, it offers a fresh response to an important challenge posed by Samuel Huntington's classic work on political order in developing societies (1968). Huntington argued persuasively that the mobilization of previously marginalized citizens in developing countries would overwhelm weak political-institutional structures leading to disorder as citizens took the streets to air their grievances in response to an ineffectual state (see also Kohli 1991). Two very different policy responses follow from Huntington's argument: one can either limit the mobilization of citizens into the political sphere or one can increases the channels by which myriad citizens can exercise their voices in politics. My argument makes a case for the latter path, advocating "more democracy" rather than "no democracy." To the extent that this process is in fact messy and disorderly, so be it. Over the long-run, I argue, such inefficiencies are more than made up for by the higher economic performance citizens enjoy.[1]

[1] Sen (1999) offers a philosophical defense of political freedoms as indistinguishable from the concept of "development."

At the theoretical level, then, my argument seeks to tackle central debates in the political science literature of the past forty years, and to do so by building on that literature by taking a new perspective in the hopes that a change in tack will yield new insights. Do the data validate this exercise? The four empirical chapters suggest they do. Using cross-national time-series data from over 100 developing countries, I showed in Chapter 3 that, even after controlling for plausible alternative political factors and for theoretically-relevant economic factors, coalition governments in parliamentary democracies have higher growth rates than other forms of government, and that such governments experience lower growth-rate volatility too. Importantly, the main findings hold up even when I use matching techniques to address potential endogeneity. Second, separate analyses reported in Chapter 4 show that coalition parliamentary governments encourage more private savings and reduce the level of capital flight experienced by the country. Together these increase the resources available to capital-scarce societies to generate growth and development. Chapter 4 also utilizes firm-level survey data from the EBRD-World Bank Business Environment and Enterprise Performance surveys to show that firms located in countries governed by coalition governments are less likely to consider regulatory and economic policy uncertainty to be major obstacles to their businesses, and that this reduced uncertainty increases their willingness to open new establishments in the near future. These survey-based findings should bolster confidence in the macro-level results by providing micro-level evidence in favor of the causal mechanisms posited by the theory.

Chapters 5 and 6 move away from cross-national analyses to country-specific analyses in order to delve deeper into the argument. Chapter 5 provides a new interpretation of India's recent economic successes based on the theoretical framework and cross-national economic results that find in favor of coalition governments. As anticipated by those findings, a cross-temporal analysis of India's national economic performance finds that India's rapid growth began only after its political system fragmented to allow more parties a chance to influence the policymaking process. Since the 1970s, India's once-indomitable Congress Party has slowly lost its grip on power at the national and state levels, beginning with a steady erosion in the number of state governments it controlled. The main loss of vote share for the Congress occurred at the hands of regional parties (Chhibber and Nooruddin 2000). This increasing regionalization of Indian politics has had an

important consequence for national-level politics: no one party is competitive throughout the country, making coalition politics a virtual inevitability today. Indeed since 1989 India has been governed either by minority or coalition governments, and there is little to suggest that this will change any time soon. Many public commentators have decried coalition governments for stalling the economic reform process (conveniently ignoring that the major economic reforms of the past twenty years were enacted by a minority government!), but my analysis suggests that the opposite conclusion might be more apt. Clearly my "credible constraints" hypothesis fits the Indian experience, but to offer an independent test of the hypothesis, I use both state-level economic data and a business survey jointly conducted by the Confederation of Indian Industries and the World Bank to identify the determinants of firm competitiveness. The results make clear once more that coalition governments reduce the probability firms consider economic policy uncertainty an obstacle, and increase the probability firms invest resources in research and development. Finally, Chapter 6 re-examines the growth patterns of Italy, Spain, Brazil, and Botswana in light of the theoretical model. In each case, the data are consistent with the predictions of the argument, confirming both the plausibility and the generalizability of the theoretical framework.

The credible constraint institutions identified in this book are more commonly found in democratic societies. While nothing in principle prevents dictators from delegating responsibility for policymaking to independent bureaucrats, experience suggests that they are loathe to do so. Even more to the point, situations in which dictators must share power akin to those in parliamentary coalition or minority governments or presidential divided governments simply do not arise. This does not mean, of course, that all dictators are equally strong, or that they can exercise unchecked power. Rather, even where leaders are not chosen by the people, they still need to satisfy a core constituency of supporters in order to retain power, what Bueno de Mesquita *et al.* (2003) call a "winning coalition." But, from the perspective of economic agents, the existence of such "checks" on dictator power are comparatively weaker, and more opaque, increasing uncertainty about future policy and affecting investment decisions (Jensen 2006).

The relative credibility disadvantage of dictatorial regimes masks the fact that there exists interesting variation in the design of political institutions within these countries (Gandhi 2008b; Gandhi and Przeworski

2006; Geddes 1999). Joseph Wright argues that dictators recognize the limits of their credibility, and therefore create "binding legislatures" to assuage economic agents' uncertainties (2008). Scott Gehlbach and Philip Keefer argue that well-institutionalized ruling parties, such as the Chinese Communist Party, provide a similar check on individual leader power (N.d.). Their argument echoes one made two decades ago by Kenneth Lieberthal and Michael Oksenberg, who described the Chinese political system as one of "fragmented authority." Their analysis suggests that "the fragmented, segmented, and stratified structure of the [Chinese] state promotes a system of negotiations, bargaining, and the seeking of consensus," leading to an "incremental" policy process (Lieberthal and Oksenberg 1988: 1). Such language is not that dissimilar from the language I use to describe my credible constraints framework, and offers the possibility that, while the particulars might be different in each case, the fundamental reasons that both China and India are growing so rapidly today are similar.

While still underdeveloped compared to our understanding of politics in developed democracies, theoretical efforts such as those described above are exciting for their potential ability to unite our understanding of how politics is conducted within democratic and non-democratic societies under a common theoretical framework. I have offered one such framework in this book. By making the inherent credibility problem faced by any political leader seeking to encourage investments and generate growth the central focus of the inquiry, we generate a coherent explanation for variation in how political institutions are designed around the globe, as well as for why some states are better able to provide superior national economic performance to their citizens than others.

So where do we go from here? What lessons can be taken from the analyses presented in these pages that might inform advice given to developing countries seeking to reduce growth-rate volatility and increase economic growth. The first implication is that governments must find ways to incorporate diverse perspectives into their policymaking, and to do so via formal institutional channels that allow opponents to exercise genuine control over the content of eventual policy outcomes. Doing so carries the obvious downside of slowing down reform processes that might be desirable, but it must be emphasized that reform is not impossible under coalition or minority government.

It is simply more difficult and requires a commitment to consensus-building. Indeed, one might well argue that reforms that do not enjoy such consensus are doomed to failure in the long-run as their negative consequences generate protests from those who were marginalized during their formulation, and who therefore seek to reverse the policies if possible (Gehlbach and Malesky 2009).

The second implication is more optimistic, and suggests the conditions required for this process to work ideally. Democracy is a process by which different societal constituencies compete for control of the reins of power. At its core, therefore, it is unpredictable because the power lies in the hands of the masses, rather than being purely concentrated in the hands of a few technocrats. Kaushik Basu sarcastically (and, in my opinion, astutely) comments on the tendency of experts to advocate democratic governance in developing countries while simultaneously advocating a particular course of policy reform as if to do so was their prerogative rather than that of the country's citizens and their elected leaders (Basu 2008). Free and fair elections can result in the election of an explicitly reform-oriented government such as the BJP-led National Democratic Alliance in 1999 in India, and its ouster five years later *in spite of* a record of high growth rates during its tenure in office. In the absence of incentives that promote consensus-building and power-sharing, such democratic unpredictability can induce policy swings that increase investor uncertainty and hurt growth prospects. But, in turn, the process of building consensus and sharing power does not come easily or automatically to political parties. Rather those who seek to lead must come to terms with the principles of "coalition dharma," treating their partners as co-equals and committing sincerely to consensual policymaking. As India's recent experience attests, when parties do so, politicians can make policy, economic agents can conduct business, and a sleeping elephant can be induced to trot, and indeed to run.