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Political Instability and Growth: Case of the Developing Countries

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Abstract

The paper attempted to examine the causal relationship between political instability and growth. Currently, the world continues to record huge number of popular revolutions in the region MENA, to improve the social environment and to consolidate implementing an effective governance. Although, the uprising has harmed the financial and economic situation in these countries, and became a threat for the stability of the countries, in overall.

The manuscript accounts for the impact of political instability on the growth of the developing countries, in the shadow of the widespread of the revolutions since 2011. The paper attempted to illuminate the reality of the relationship between political environment

and growth through the estimation of panel, comprising 69 developing countries 1985-2012.

In the current paper, the authors conducted an empirical investigation, in which we bore out the claims raised in many surveys and the conclusions drawn by several authors about the harmful impact of political instability on the fundamental bases of the economy, in countries recording political instability.

Keywords: political instability, war, good governance, growth

1. Introduction

Recently, we could consider political instability, wars and institutions weakness as common and fundamental feature of developing countries, these latter remain unable to formulate appropriate policies that encourage long-term growth, under such conditions. This statement could provide explanation for the under development of the Sub-Saharan African countries, which have recorded several political violence or civil wars. In fact, more than half of these countries had registered political conflicts in 2000 against 11% in 1999. The tendency of the rise of the political instability could be carried out by the inequality of revenue distribution, the economic decline, the fall of the state, the legacy of European colonialism and the Cold War…

The current article attempts to examine the nature of the causal relationship between political instability and economic growth in developing countries. Thus, we begin by putting forward the literature review that highlight that connection. Then, we will reveal the findings from the empirical study conducted on the period stretching from 1985 to 2008.

2. Literature Review

The literature about the political stability and growth is abundant, several empirical papers relied on exploring the relationship between political environment and economic development. The bulk of the empirical investigations revealed that strong political institutions tend to raise the growth. Generally, countries in sub-Saharan Africa have experienced high levels of political instability since the 1950s that could explain the reduction of their economic performance.

2.1 Political Instability and Growth

According to many definitions, the political instability is considered as a "complex concept" and "covers two distinct realities: changes in political power through violence and regular changes in the due process of law". Fosu (1992) demonstrated, through cross-sectional data on thirty-one African countries, the negative correlation between political instability and economic growth as the direct result of deteriorating the efficiency of capital accumulation.

It's obvious to identify the negative effects of political instability on economic growth, which remain in accordance with the statements raised by several authors. Mead (1990)[1] considered the political uprising as an increasing factor of poverty. For Alesina et al. (1992), political instability is also regarded as a decreasing element of the rate of economic growth and

[1] Mead, L. (1996), "Poverty and political theory", American Political science association.

according to Devreux and Wen (1996) and Gupta (1986), it is a common cause of deterioration of the investment.

The explaining of the inverse connection between growth and political instability relies on the following mechanism. An increase of the likelihood of uprisings and violence tends to rise the uncertainty and in return, it threats the fundamental bases for any economic activity (property right, rule of law, corruption, security…). In similar political environment, the investment is affected negatively and hence the growth. According to Alesina and Perotti (1996) and Barro (1996), the democracy plays a pivotal role in achieving the economic growth, for the authors, building strong democracy should avoid political instability, corruption and uncertainty in the economy, and in return, it leads to realize a sustainable economic development.

Alesina and Perotti (1994) have demonstrated the negative effect of political instability on economic growth. Their results bore out the finding about the harmful impact of instability on economic growth. The authors highlighted and classified the harmful effects of political instability into directly and indirectly. The direct effect comes out through the impact on total factor productivity and the indirect effect appears through the accumulation of physical and human capital.

Similarly, Laline (2010) has shown that during a fiscal year in Haiti, the economic growth rate was 0.0013%, the decrease noted was essentially due to the political instability occurred in the country. Murphy et al. (1993) demonstrated the crucial role of property rights and the rule of law in improving the economic growth. In addition, they revealed a poverty trap in the absence of property rights and laws.

Hall and Jones (1999) have shown the pivotal role of institutions and government policies on economic growth. Several empirical papers bore out the statements raised by many authors, such as: Hall and Jones (1999), Knack and Kefer (1995), Acemoglu et al. (2001), Acemoglu, Johnson and Robinson (2001, 2002), Dollar and Kraay (2003), Easterly and Levine (2003) and Gleaser et al. (2004).

Collier (2006) carried out that the low degree of political responsibility of the authorities, vis-à-vis their citizens, is harmful for growth. The failure of government is often due to misplaced priorities, overspending, mismanagement of investments, projects and policies adopted, affecting public property, a mediocre quality of services, and corruption.

2.2 Political instability, Governance and Growth

We could define "good governance" as "the exercise of authority, economic, political and administrative to manage the affairs of a country at all levels". It comprises mechanisms, processes and institutions through which citizens and groups articulate their interests and differences, exercise their rights and fulfill their obligations. Governance includes the state, but transcends it by including the private sector and civil society organizations"[2]. It is in this sense that the report of the World Bank in Africa in 1989 stressed that the development

[2] United Nations (2006), "Definition of basic concepts and terminologies in governance and public administration", Economic and social council.

problems in Africa are due to a crisis of governance.

Kaufmann, Kraay and Lobaton (1999) have identified six governance indicators that are: “voice and accountability”, “government effectiveness”, “regulatory burden”, “law”, “corruption” and “political instability and violence”. These indicators include some sub indicators that measure the fall of government through non-institutional and/or violence. In sum, all these global indicators of governance demonstrated the strong correlation between good governance and economic performance, such as higher literacy, lower infant mortality and increasing per capita income.

Several studies have demonstrated the crucial political stability in maintaining macroeconomic stability. Akagul (2005) found that political stability is a necessary condition for macroeconomic stability, to realize a long-term growth. Similarly, Knack and Keefer (1997) have shown the importance of confidence in government to increase the economic growth.

We should note that the bulk of African countries continue to record permanent political instability, le last is the direct result of the adverse socioeconomic impact on the continent. Thus, Egolote (2002) illustrated the harmful effects of political instability on many countries of Africa. The author stressed that instability produces exclusion, racial discrimination and violence and has led to the increase of the number of refugees, which has considerable impact on human development of the countries. It appears that political instability is an immediate consequence of armed conflicts, which plague in most African countries and a brake on economic growth: “In West Africa a series of violent internal conflict sets stability throughout the region since 1989. These conflicts are not only human disasters and sources of economic and political instability. They thwart a strong and sustained growth in the sub region and the delay in the countries where they are rampant, compared with those who are relatively stable”. In this regard, the former Secretary General of the United Nations, Annan (2001), reports: “many African countries are heading towards a potential conflict while others are already involved in a conflict” and he adds that: “These conflicts bring only devastation. They cause untold suffering and cause considerable loss of life in most societies to fragment and cause the collapse of economies”. Similarly, T. N'Guessan (2005) notes that: "The impact of war on the divestment, the destruction of physical infrastructure and the deterioration of human capital through disability, death and displacement, is difficult to quantify." It appears from these studies that political instability reduces investment and negatively affect growth through harming the institutions.

3. Empirical Analysis

In this paper, we attempted to carry out an econometric model to illustrate the effect of political instability on growth of countries.

3.1 Methodology

The empirical investigation focuses on panel estimation to account for the significance of some political variables on growth. The panel is made up of 69 countries. Then, we will proceed to segment the panel into two components: and re-estimate the model for the developing countries solely. We could put forward the estimated model like following:

$$Growth_{it} = Cst + \alpha_1 X_{it} + \alpha_2 Y_{it} + \mu_i + \lambda_t + \varepsilon_{it}$$

Where:

Growth is the growth of the country.

X_{it}: group of explanatory variables covering the economic field: population rat, public transfers, consumption as share of GDP, private investment, secondary education and expenses on education.

Y_{it}: group of explanatory variables covering the political stability and the institutional quality: political rights, civil liberties and revolution number to find out the impact of the political instability.

μ et λ : represent respectively specific effects by country and time.

i, t : represent respectively the country and the period.

ε : is the error term.

The data used in the empirical investigation that we conducted in the current paper is covering the period 1985-2012. The authors retrieved the data from the World Bank database: World Development Indicators 2012. The empirical investigation carried out in the article relies primarily on determining the impact of some economic and political factors on growth.

According to the econometric literature, we should apply some empirical tests to determine the appropriate final form to estimate. First, we applied the poolability test to assess if the model is pooled or should be estimated by considering the presence of fixed effects. And then, we applied the Hausman test to assess if the model is properly estimated with fixed or random effects (Annex).

In the current empirical investigation, we finished by finding that the appropriate form to estimate is the fixed effects model, according to the obtained tests, which means that every country has specific factors that affect its growth than others in the same group, because of the panel heterogeneity, containing: developing and developed countries.

3.2 The Results

The results found from estimating the model for the panel for the period 1985-2012 as following:

Table 1. The effect of political and economic factors on growth

Variables	All countries		Developing countries	
	Coefficient	t-stat	Coefficient	t-stat
Population rate	0.017	0.15	0.58	5.33
Public transfers	0.66	2.34	0.84	2.36
consumption share	-0.31	-10.6	-0.07	-3.06
consumption share(-1)	0.42	15	--	--
consumption share(-2)	-0.12	-4.68	--	--
Private investment	0.06	2.44	0.066	2.38
Revolution number	-2.21	-2.77	-2.45	-2.78
Civil liberties	-0.78	-3.71	-0.93	-4
Secondary education	0.01	0.13	0.002	0.02
Political rights	0.04	0.28	0.19	1.09
Education expenses	-0.18	-1.36	-0.10	-0.65
C	-1.33	-0.43	0.89	0.22
growth(-1)	0.28	11.32	0.16	5.80
R2	0.32		0.19	

3.3 Interpretation

Despite of segmenting the panel into two samples, to carry out if there is some common effects related to the development degree of the countries, included in the empirical investigation, and to find out the impact of political variables for a group containing developing countries solely, we found similar results to the outcome obtained through estimating the heterogeneous panel. The similarity authorizes us to infer the significance of the number of developing countries in the sample estimated. In fact, the whole sample contains 60 developing countries and 9 developed countries.

The empirical research demonstrates that an increase in the public consumption tends to reduce the growth, it enables us to point up the major ineffectiveness of the governmental expenses that seems not targeting productive field.

In fact, to illustrate the harmful impact of public consumption, we could refer to economic literature, which consider the public consumption could affect positively the growth in long run solely, for example: the expenses on health and education. What bear out the current reasoning, the including of lagged terms of public consumption in the model, revealed positive coefficients for lagged public consummation. The impact of public consumption on the period t-1 is statistically significant at 1%. According to Novales et al. (2012)[3]: “under the Markov policy, public consumption increases to about 10% of output.”

For the public transfers, it appears that an increase in the transfers is associated with a rise in the growth of the countries, it enabled us to infer that governmental transfers are effectively

[3] Novales, A., Pérez, R. and Ruiz, J. (2012), « Optimal time-consistent fiscal policy in an endogenous growth economy with public consumption and capital ».

targeting the wealth of population. Therefore, referring to the paper of Rochoux (1997)[4], the author concluded similar findings: "good macroeconomic results due to significance of public transfers from European union".

The positive coefficient of private investment point out similar deduction to the effect of the public transfers. In fact, according to the economic literature, the private investment plays pivotal role in economy, it contributes in the job creation and in the production of the country, in overall. The private investment remains a significant factor that allows an effective catalyst for growth. Referred to Ghura (1997)[5]: "private investment plays a crucial role in output expansion".

Observing the sign of the variable « revolution number », it shows the harmful impact of political instability on growth. We could illustrate the negative impact of revolution on growth by the environment of risk created after every revolution. Under the environment of uncertainty, investors prefer to leave the country recording political instability, to find an appropriate climate providing security and guaranteeing less exposure to risk. According to the multilateral investment guarantee agency (2009)[6]: "these perceptions are influenced by broad geopolitical and economic trends".

For the variable « civil liberties », it tends to reduce the growth of the countries of the sample. The obtained result enabled us to infer that developing countries are not improving the civil liberties in their territories, they record decrease in economic growth. In fact, the civil liberties reflect the social and the institutional quality of the country, so any deterioration in these liberties is indicating an increase in the risk exposure for business and private property, and in return, it harms the capital accumulation and then the growth.

For the education, it tends to improve the growth of countries but its impact remains statistically non-significant. In the bulk of developing countries, education remains inappropriate with the demand of the employment market and the requirement of new economies, recruiting highly qualified labor in technology. In several empirical surveys, education is reflecting human capital quality, it seems that the capital human quality remains insufficient in developing countries to stimulate growth.

For the political rights, it tends to improve the growth of countries but this impact is statistically non-significant. This impact reflects that the bulk of countries studied in this empirical investigation are not adopting political system encouraging the contribution of population in the political environment. So, the outcome reflected the bad governance of the developing countries, and finished necessarily by harming growth.

Concerning the education expenses, it appears that it tends to harm the growth, but its effect is not statistically significant. We could illustrate the result by the huge amount of resources to build an effective education, appropriate with the future requirement of the economy. Thus,

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[4] Rochoux Jean-Yves (1997), « Transferts financiers publics et développement régional le cas d'une région d'outre-mer : la réunion », Revue région & Développement n°5.

[5] Ghura D. (1997), "Private investment and endogenous growth: evidence from Cameroon", IMF working paper WP/97/165.

[6] Multiateral investment guarantee agency (2009), « World investment and political risk », World Bank group.

we could explain the harmful impact of the education expenses by the weak system of education in the bulk of developing countries. In fact, the education should be the prime factor to create qualified labor, and in return it contributes to improve the competitiveness of the economy. However, considering the obsolete manners and the weak system of education in developing countries, definitely, it should harm the capital accumulation and then the growth. According to Goodnight (2006): "education and training have emerged as key drivers of competitiveness ensuring that the labor force has access to new technology…".

For the variable representing the lagged growth, it has positive impact and significant statistically. It seems evident in economic literature that recorded richness affect directly the future wealth of any country. In addition, many authors adopt the autoregressive models to carry out growth.

4. Conclusion

The current manuscript shed the light on the pivotal role of political stability on growth. We could sum up the main object of the paper in attempting to reveal the nature of the causal relationship between the political instability and growth. Primarily, recently, the word has recorded a widespread of political revolutions occurring in Arabic countries, and it seems crucial to carry out their impact on the growth of the developing countries.

The paper attempted to provide explanation for the harmful impact of political instability on growth. The authors carried out an empirical investigation that relied on rigorous methodology, based on estimating a panel containing developed and developing countries. The issue debated in the current paper remains interesting and in accordance with the current political events in the Arabic countries.

The empirical investigation of the article enabled us to reveal the significance of the political stability as determinant and prime factor to stimulate the growth in developing countries. It illustrates the harmful impact of the uncertain environment and security on growth, thus it bear out the claims raised in surveys attempting to explore the topic of political instability.

Although, no one can deny or bear out if the future effects of revolutions will improve or harm the growth, but, the main contribution of the paper relies on considering the prime significance of governance highly involved with growth in developing countries, it was summarized in the sign of the variables: political rights and the civil liberties. However, the paper could underline solely the harmful impact of revolutions on the growth of developing countries.

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Appendix

We could sum up the several tests applied on the estimated panel, as following:

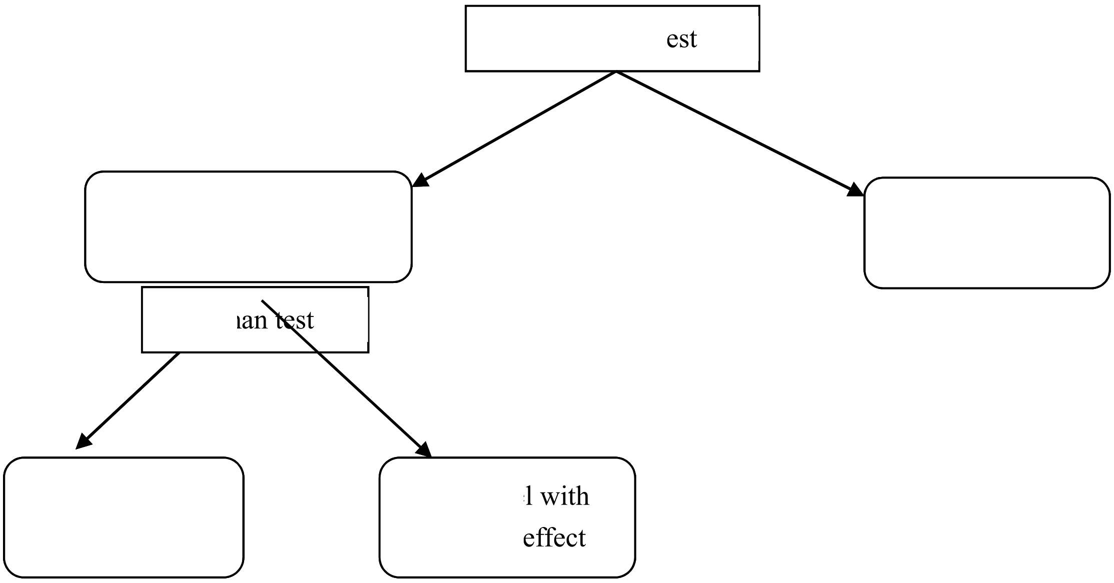

Figure 1. Empirical tests in panel model

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