

## 11 Political economy of economic policy making in developing countries

### An overview

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In this essay I shall not confine myself to just the four developing countries – Burma, Haiti, Nicaragua and Zambia – discussed in the subsequent chapters. This is partly as these are not a representative sample, all being failed states, of which only Nicaragua seems to have achieved some economic and political viability in the 1990s. But, they do provide examples as we shall see, to illustrate particular aspects in the general overview of the political economy of economic policy making in the heterogeneous set of countries and polities that make up the developing world, which I have spent the best part of the last fifteen years trying to develop in two books, Lal and Myint (1996) and Lal (1998a).<sup>1</sup>

In organizing one's thoughts as well as the diverse experience of the myriad of developing countries it is essential to have some classificatory scheme. Section 11.1 provides the one I have found most useful. Given the current penchant for the West to launch a crusade in favour of its 'habits of the heart', democracy is being touted as essential for development. So in section 11.2, I go beyond the pure classificatory devices of the first section to see if there are deeper reasons why countries fall into these particular political-economy categories and if it is likely that they will give up their traditional political habits because of Western exhortations and 'conditionality'. Section 11.3 then goes on to examine if the on-going process of global economic integration is likely to alter the political economy of policy making outlined in the first section.

#### 11.1

In Lal and Myint (1996) we found it useful to categorize countries by a five-fold classification of polities and a three-fold classification of economies based on factor proportions. The latter were countries which compared with the world endowment of capital, labour and land were classified as 'labour abundant', 'land abundant' and 'intermediate'. This allows an application of the three-factor trade theoretic framework of Krueger (1977) and Leamer (1984, 1987) to yield a rich menu of alternative efficient development paths, and the implied patterns of changes in

the functional distribution of income as with capital accumulation and population growth the factor endowments of the relevant countries change over time.

The five-fold classification of the polity distinguished between the objectives of the government and the constraints on its activities. On the former distinction two basic types were distinguished: the autonomous and the factional state. In the former the state subserves its own ends. These differing objectives allow a further subdivision. The first is the benevolent Platonic guardian state of public economics seeking to maximize some social-welfare function. The second is the predatory state whose self-seeking can take either the form of the absolutist state seeking to maximize *net* revenue for the sovereign's use or the bureaucratic state maximizing public employment.

A state is needed to provide the classical public goods of defence and justice. For their provision the state has to have a monopoly of coercive violence (including the power to tax) in its territory. It is therefore best viewed as a natural monopoly providing these public goods. Being as self-regarding as its citizens (except for the Platonic guardian version), the autonomous state's public goods cum tax equilibrium which yields the net rents it can obtain from its natural monopoly will depend upon the extent to which its natural monopoly is contestable from internal and external rivals. The greater the barriers to entry the greater the net revenue the state can garner for its own purposes. But even if this contestability is very low, there will be a further constraint on the autonomous state's ability to levy confiscatory taxes. Particularly in developing countries, where a subsistence rural sector and an untaxable 'informal' urban sector are common, as the net of tax income decreases, at some stage the 'prey' will exit the taxed sector and melt into the bush (as happened, for example, in Tanzania and Ghana in the 1960s and 1970s). While this puts an upper bound on the tax rate even when the state's natural monopoly is not contestable, in practice depending upon geography, military technology, and the internal legitimacy of its rulers, the maximum tax rate will be much lower, and will depend on this degree of contestability.

Of the three types of autonomous states, the Platonic guardian one provides the optimal level of public goods at least cost. The predatory-state tax cum public-goods equilibrium will be with a net-revenue-maximizing tax rate (determined by the degree of contestability) and the provision of less than the ideal amount of public goods in the absolutist version, and an over-provision in the bureaucrat-maximizing version.

The factional state by contrast has no objectives of its own but subserves those of whoever is successful in its capture. Two major types can be distinguished – the oligarchic state and a majoritarian democracy. The former limits the polity and hence the contestants to the state's capture, while the latter extends the polity to the adult population. As is well known from the median-voter theorem, the 'predator' in a majoritarian democracy will be

the median voter with their well-documented 'middle-class' capture of the unavoidable transfer states that result, in both developed and developing countries. Moreover, the tax rate will be the revenue-maximizing one based on the so-called Ramsey tax rule (see Becker, 1983; Brennan and Buchanan, 1990; Lal, 1994: Ch. 13), as in the case of the autonomous predatory state, while the provision of public goods will be close to that of its bureaucrat-maximizing version (with pure public goods being supplemented with 'merit-good' provision).

Where do the four countries discussed in subsequent chapters fit into this classification? Clearly, Haiti is a classic predatory state, where one predatory 'sovereign' (the two Duvaliers) have been succeeded by another (Aristide) seeking to become one. Zambia under Kaunda would also fit in this category, but since his fall it is hovering between a factional state of the oligarchic, and a continuation of the net-revenue-maximising predatory kind. Burma has clearly been a predatory state of the bureaucratic-maximising type, while Nicaragua after the ending of its civil war seems to be a majoritarian democratic factional state.

In Lal and Myint (1996) we found that the initial resource endowment was more important in explaining divergent policy regimes and outcomes than the polity. Thus the labour-abundant countries (e.g. Korea, Singapore, Taiwan, Malta), irrespective of their polities, had the easiest policy-making task. For them the standard policy prescription of the two-factor Heckscher-Ohlin model of initially developing labour-intensive industries and then moving up the ladder of comparative advantage is easy to follow. First, this policy leads to politically desirable factor-price movements. With wages rising as capital is accumulated, there is unlikely to be political resistance from the bulk of the population in factional states which realize the country's comparative advantage. While all types of autonomous state will also find that even their predatory ends are better served by undertaking the development of their only resource – the human – on which their revenues and prosperity depend. The major task of government is to provide an adequate infrastructure to reduce the transactions costs of the relatively small-scale organizational units which will predominate in the earlier stages of their development. Second, if the country is small, the limited size of the domestic market makes reliance on foreign trade inevitable. Also, there is unlikely to be vertical-import substitution when the ubiquitous dirigiste impulse leads to some departures from free trade. This means that when a switch to free trade is made there will not be lobbies preventing competitive imports of intermediate inputs. The political costs of rectifying past mistakes are, therefore, likely to be lower than in the land-abundant or intermediate group of countries. Third, their incremental comparative advantage is readily apparent to economic agents in both the private and public sectors. It is thus easier to pick 'industrial winners' and the consequences of picking losers or policies which stimulate them are more immediately apparent – as with Singapore's ill-judged attempt to

jump a few rungs on the ladder of comparative advantage through an artificial raising of wages in the 1980s.

Of the four states discussed in later chapters, only Haiti with its population expansion relative to land would seem to fall into this category. But with a failed state, there seems to be no obvious way in which even the basic public goods – law and order – required for any economic activity can be provided.

The comparative advantage of land and natural-resource-abundant countries is also likely to be clearer than for the intermediate group, but more difficult to realize than for the labour-abundant group of countries. This is for two reasons. First, with a higher supply price of labour than the labour-abundant countries, due to their more favourable land-labour ratios, their incremental comparative advantage is likely to lie on the relatively capital-intensive rungs of the ladder of comparative advantage. Public promotion may be required because of the ensuing lumpiness of investments, and the need to develop scarce skills and absorb complex imported technology. The dangers of 'bureaucratic failure' endemic to such promotion may then lead to a failure to realize their economic potential. Second, if the rate of capital accumulation is not high enough, then with growing labour forces, their efficient development path could contain declining real-wage segments. If the polity is subject to factional democratic pressures, this 'equilibrium' time path of real wages could lead to political pressures to resist the requisite real-wage adjustments by turning inward. The polity could be at odds with the economy, with political cycles of economic repression (during factional 'populist' political phases) followed by liberalization (during autonomous political periods). Third, given the political imperative of avoiding the 'falling-wage' segments of their development paths, such countries have attempted 'big push' development programmes, often financed by foreign borrowing. This big push has often pushed them into a fiscal and debt crisis and thence a growth crisis. Finally, given the rents available from the natural resources, the inevitable politicization of their disbursement leads to 'transfer states' which inevitably bear harder on the revenue-generating sector in terms of trade decline, while raising entitlements when they improve. Thus natural resources may prove a 'precious bane' leading to politics which tend to kill the goose that laid the golden eggs.

The story of Zambia told in a subsequent chapter as well as the current travails of South Africa and Russia would fit these patterns in the political economy of natural-resource- and land-abundant countries. The story of Burma would fit to some degree too, but it is also strongly conditioned by the predatory nature of the state.

Finally, the intermediate resource-endowment group faces the most difficult development policy task. Their incremental comparative advantage is more opaque, so 'mistakes' are not so easily recognized or rectified, particularly by the public sector, which in the absence of any bankruptcy

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constraint resists the exit of inefficient firms. Secondly, this group is also more likely to face situations in which the polity is at odds with the pursuit of their comparative advantage. Two of the largest developing countries – India and China – fall into this category (see Lal, 1995).

There is also overwhelming evidence that, as first hypothesized in Lal (1987), a 'crisis' provides an important impetus for initiating economic reform (see Little *et al.*, 1993; Bruno and Easterly, 1996; Lal and Myint, 1996). This has happened in all four of the countries discussed in later chapters, though only Nicaragua seems to have been able to get closest to a sustainable economic recovery after its economic reforms.

In these cases of 'crisis'-induced reforms, there are important parallels with the liberalization of the mercantilist 'ancien regimes' in the late eighteenth and nineteenth centuries (see Hecksher, 1955; Lal and Myint, 1996). One unintended consequence of past mercantilism and contemporary neo-mercantilism is that, while both were motivated by the desire to establish 'order' and thence 'nations' by expanding the span and scope of government control, after a certain stage increased *dirigisme* bred disorder. As economic controls become onerous, people attempt to escape them through various forms of avoidance and evasion. This has a devastating effect on the state's fiscal base. The first sign of an impending crisis is fiscal, with the accompanying unMarxian 'withering away of the state'. It is to regain control over what seem to have become ungovernable economies that economic liberalization is undertaken, to restore the fiscal base and government control. But there may be a lot of ruin in countries – as the decades-long crisis in Ghana demonstrated. Moreover, if even half-completed reforms allow this crisis of the state to seem manageable, there is no further incentive for predatory states to continue with liberalization. The recent stalled Indian liberalization provides a salutary example.

This suggests that a crisis usually provides a small window of opportunity for liberalizers. A 'big bang' may, therefore, be desirable to smash the equilibrium of 'rent-seeking' interest groups who have a stake in maintaining the past system of dirigisme. It had been thought that to stiffen the government's spine in this unenviable task, sweeteners which ease its fiscal problem, in the form of 'conditional' soft loans and grants from multilateral and bilateral donors might be useful. But the emerging consensus from the sorry experience of 'conditional' lending is that, unless the government has decided to 'bite the bullet' which inevitably involves rescinding the politically determined income streams its past dirigisme has created, invariably predatory governments just 'take the money and run'. The recent sad history of aid to Russia and Kenya, for instance, would support this judgement. So it is now being recommended that aid should only be given to those who 'ex post' are known to have reformed (see Collier and Gunning, 1999)!

## 11.2

An obvious question following from the above discussion is why do countries have the political forms we observe? A second and related question is whether, as the West is currently asserting along with the market, other of its 'habits of the heart', in particular its political form – democracy – needs to be adopted to aid development.

My Ohlin lectures (Lal, 1998a) tried to provide a cultural explanation. I distinguish between two aspects of a culture – its material beliefs which are concerned with ways of making a living and its cosmological beliefs which in Plato's words relate to 'how one should live'. There is considerable cross-cultural evidence that material beliefs are fairly malleable – when the environment changes they can rapidly alter. By contrast, there is greater hysteresis in cosmological beliefs and it seems they are related to the beliefs of the parent-language group from which the culture emanated.

Cosmological beliefs are also of importance for the polity. No matter how tyrannical and predatory the state, it must command some general acceptance of its legitimacy by the general populace. For the ancient 'states' this general acceptance of its right to rule and the political form which is considered legitimate depend upon ancient political habits. To understand these political habits and hence the feasibility of different political forms we need to look at the history and cosmological beliefs of the people. The chapter on Haiti, and Lundahl's other work, strongly suggests that the continuation of the strange predatory state in Haiti is largely explicable in these terms, so that even when democracy was introduced it has not taken any root.

I also argued in *Unintended Consequences*, that the political habits of different cultures were formed as much by the geography of the territory where the relevant culture was formed than by any ideology. Thus, China in its origins in the relatively compact Yellow River valley, constantly threatened by the nomadic barbarians from the steppes to its north, developed a tightly controlled bureaucratic authoritarianism as its distinctive polity which has continued for millennia to our day. By contrast Hindu civilization developed in the vast Indo-Gangetic plain, protected to a greater extent by the Himalayas from the predation of barbarians to the north. As I argued in *The Hindu Equilibrium* (1988), this geographical feature (together with the need to tie down the then scarce labour to land) accounts for the traditional Indian polity which was notable for its endemic political instability amongst numerous feuding monarchies, and its distinctive social system embodied in the institution of caste. The latter, by making war the trade of professionals, saved the mass of the population from being inducted into the deadly disputes of its changing rulers. While the tradition of paying a certain customary share of the village output as revenue to the current overlord meant that any victor had little incentive to disturb the daily business of its newly acquired subjects. The democratic

practices gradually introduced by the British have fitted these ancient habits like a glove. The ballot box has replaced the battlefield for the hurly-burly of continuing 'aristocratic' conflict, whilst the populace accepts with a weary resignation that its rulers will through various forms of 'rent-seeking' take a certain share of output to feather their own nests.

By contrast consider the Americas. Both North and Latin America shared similar resource endowments, with an abundance of land and scarcity of labour. Whereas much of development economics is concerned with the development of labour-surplus economies of relevance for Asia, it is the economics of land-abundant, labour-scarce economies which is relevant for the New World. A seminal essay by Domar (1970) provides the necessary theoretical framework. He cogently argues that in a land-abundant economy, free labour, free land and a non-working upper class cannot coexist. Any two can but not all three.

Thus consider the case where land and labour are the only two factors of production. Land is so abundant that there are no diminishing returns to labour, whose marginal and average product are the same ( $mpl = apl$ ). If employers seek to hire labour, they will have to pay a wage equal to this common marginal *and* average product of labour, leaving no surplus rents from land for the employer. Hence the agrarian form that will emerge is family-labour-based farms, as any form of hired labour or tenancy will be unprofitable and landlords – who have to depend on one or the other – cannot exist. A government, by taxing this independent peasantry through direct or indirect taxes, could support a non-working class of retainers; but the latter or an independent nobility of landlords could not support themselves from land rents – as none would be available. Economic expansion based on an independent yeomanry was the form that North American development and its agrarian structure took in the colonial period. Next, suppose the government wants to create an independent class of landowners and grants the chosen few sole rights of ownership to land. If the peasants are free to move, competition amongst landlords will drive the rural wage up to the marginal product of labour which is close or equal to its average product because of the abundance of land. There will be little or no surplus left for the landlords. In order to provide this surplus some means will have to be found to restrict or abolish the peasant's freedom to move. Various forms of tying labour down to land – serfdom, slavery and the caste-system – emerged in the great agrarian civilizations. They created a landowning class which derived a rent not from land but from the peasants by expropriating a large part of their income above a subsistence level.<sup>2</sup>

Finally, as the labour force expands from natural increase and/or migration and land becomes scarce relative to labour, diminishing returns to labour appear with the  $mpl < apl$ . This allows landlords to obtain the rents from land and an assured labour supply to work it through hired labour paid its  $mpl$ , or else through various forms of tenancy.

The land-abundant US sub-continent was gradually tamed by the gradual westward spread of the family farm. In Latin America

a society of small farmers failed to take shape. Spain could not export many, and in America the lure of mines, the possibilities of large scale, preemptive acquisition of land, and the opportunities for exploiting Indian and African labour militated against such a design.

(Morse, 1964, p. 128)

Equally important were the differing ecological conditions for agriculture in North and South America. In the North, unlike the tropical parts of the Americas, grains were the most suitable crops for cultivation. These have constant returns to scale in their production, unlike plantation crops like sugar which have increasing returns to scale. The same is true, to a lesser extent, of tobacco and coffee.<sup>3</sup> Where climatic conditions in the Americas were suitable for cultivating tropical crops, the use of coerced labour had enormous cost advantages over free labour, which led to great social and economic differentiation in society with large inequalities of income and wealth.

By contrast, given its factor endowments (including the climate), in most of the US (except for the South) the family farm became the backbone of the colonial economy and a society with fairly egalitarian mores could develop. That these factor endowments (including the climate) rather than the cultural differences between the Protestant North and Catholic South were responsible for the development of these different types of societies in the Americas is illustrated by the case of the Puritan colony of Providence Island, which developed the Caribbean and Latin American pattern of land ownership and settlement rather than the North American one of its co-religionists.<sup>4</sup>

These cultural differences were vital however, in the different polities that were established in the areas of Iberian and Anglo-Saxon colonization. Morse (1964) argues that Spain after the reconquest (from the Moors) was a patrimonial state in which feudalism never developed fully. It was a centralizing state without the decentralization of rights of the manorial system.

The patrimonial rather than feudal states that Latin America inherited were further distinguished by their Catholic lineage. Whereas in the Protestant colonies – as Luther succinctly expressed in his 'Open Letter to the Christian Nobility' – the duty of Christians who found themselves in a land populated by pagans

was not to convert the pagans but to elect their own religious leaders. The American Indians ... were ... to be tamed or exterminated. Moreover, the idea of salvation of one's neighbor never enters the Calvinist ethic because only divine grace, not human action, can save

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man ... As the intermediaries between the individual conscience and God are suppressed, the evangelizing mission of Christianity disappears.

(Paz, 1988, p. 27)

By contrast evangelism was the public justification given for the Conquest and for the Spanish and Portuguese domination of Latin America. New Spain even more than its parent state adopted the neo-Thomism developed by Suarez and his disciples as part of the Catholic church's revitalization during the Counter-Reformation. This provided an ideological justification for the patrimonial state. Society is considered to be a hierarchical system in which every person and group 'serves the purpose of a general and universal order that transcends them' (Morse, 1964). This hierarchy is part of a universal and natural order and not the product of any social contract. The sovereign is responsible to God not to society even though his authority originates in the people.

Neo-thomism was a philosophy destined to offer a logical and rational justification of the Christian revelation. In turn the teaching and defense of the Christian revelation formed the basis of the Spanish empire. Religious orthodoxy was the foundation of the political system.

(Paz, 1988, p.30)

Its economic correlate was corporatism.

This political and economic system was *par excellence* an 'enterprise' association as delineated by Oakeshott (1993). By contrast, the Protestant colonies were relatively indifferent to religious orthodoxy. In the previously cited work, Luther maintained that, in the colonies, if a group of Christians had no priest or bishop amongst them they should *elect* one of themselves as a priest and this election would not only legitimize their authority but also consecrate it (see Morse, 1964; Paz, 1988). As Paz notes, 'nothing similar exists in all of Catholic tradition' (p. 27).

Thus in the Protestant North a pluralist society developed, with the view that

the world is composed not of one *highly differentiated society* for which certain common forms, acts, and ceremonies are a needed binding force, but of a *multitude of unrelated societies*, each of them a congregation of similar persons which in finite time and place are ordered by the declarative terms of a compact rather than by common symbolic observances.

(Morse, 1964, p. 152)

This allowed the notion of the state as a civil association (in Oakeshott's terms) to develop, with the state as the umpire between many competing

interests. This difference in what I like to call cosmological beliefs (see Lal, 1998a) explains the observation by political scientists that:

politically, North Americans confine their feuds primarily to selecting officials and debating public policies, but in Latin America feuds are more fundamental ... democrats, authoritarians, and communists ... all insist they know what is best for themselves and their neighbors.  
(Wynia, 1990, p. 3)

This 'universalism' of the neo-Thomist tradition was further strengthened by the attempt of the Jesuits in Latin America (and in other parts of the world) to promote a religious syncretism which would lead to a 'unification of diverse civilizations and cultures ... under the sign of Rome' (Paz, 1988, p. 39).<sup>5</sup>

This fundamentalist universalism also provides, in my view, an explanation for the continent-wide swings in political and economic fashions over the last two hundred years.<sup>6</sup> In the post-war era, the pronouncements of the Economic Commission of Latin America (ECLA) have been accorded the status of gospel truth. When it advocated dirigisme, that became the policy for most of Latin America; when it finally endorsed economic liberalism in the early 1990s, that has become the new gospel. More than other parts of the world, therefore, a universalist ideology matters in Latin America. This seems to be very much part of the story of the wild swings in ideology and policy to be found in the case of Nicaragua outlined in this book. Instead, therefore, of searching as political economists do in other Western societies for the changing equilibrium of interest groups, in Latin America one needs to explain how these intellectual swings of 'fashion' take place, as they are rather like religious conversions – Menem in Argentina and Cardoso in Brazil being outstanding examples.

This penchant for universalist ideological beliefs has also meant that there is a continuing dissonance between the Latin American social reality of the extreme inequalities which are the result of its ecological and political heritage and its Christian cosmological beliefs emphasizing equality – which it of course shares with the North. There is no such Northern dissonance as both for ecological and political reasons a uniquely egalitarian social and political society developed there.

In this context it is worth noting the important difference between the cosmological beliefs of what became the Christian West and the other ancient agrarian civilizations of Eurasia. Nearly all of these believed in some form of hierarchical social order, which for instance in Hindu India – with its belief in reincarnation – was rationalized as resulting from the system of just deserts for one's deeds in the past life. By contrast, alone among the Eurasian civilizations, the Semitic ones (though least so the Jewish) emphasized the equality of men's souls in the eyes of their monotheistic Deities. Dumont has rightly characterized the resulting pro-

found divide between the societies of *Homo Aequalis* which believe all men are born equal (as the *philosophes*, and the American constitution proclaim) and those of *Homo Hierarchicus* which believe no such thing.

This matters for the polity. With the rise of *Demos*, those societies infected by egalitarianism have a greater propensity for the populism which damages economic performance than the hierarchical societies. If as in Europe the granting of democratic rights can be phased in with the growing economic and social equality that modern growth helps to promote, then the political effects of the dissonance between an unequal social reality and egalitarian cosmological beliefs can be avoided. In the colonial and nineteenth-century patrimonial states of Latin America this dissonance was avoided by restricting the polity – in effect to the property owning classes. But if, as in this century, while still in the early stages of modern growth, the polity is expanded by incorporating the ‘dangerous classes’, through an extension of democratic rights to the whole populace, then this dissonance can, as it has, lead to political cycles of democratic populism followed by authoritarian repression as the distributional consequences of the populist phase are found unacceptable by the ‘haves’. By contrast, hierarchical societies can more easily maintain majoritarian democracies, however corrupt and economically inefficient – as the notable example of India shows – despite continuing social and economic inequalities. Thus, as many Latin American commentators<sup>7</sup> have noted, the historic and continuing inequalities of Latin America make democracy insecure, largely – I would argue – because of the dissonance between ‘society’ and ‘cosmology’ noted above.

Finally, consider sub-Saharan Africa, where the largest number of the world’s failed states are to be found. The major point to be noted about African states is their artificiality. They are the result of the nineteenth-century colonial scramble for Africa. These artificially created states have neither the ancient homogenous tribal identity of a state with loose association with tribal chiefs providing the necessary governance. Nor have they succeeded in behaving like imperial states. These have historically provided a means of welding a multitude of ethnic and religious groups into a functioning state. I have elsewhere (Lal, 1999a) distinguished two major types of imperial state: the genuinely multi-ethnic states such as the Austro-Hungarian and Ottoman empires, which were mainly concerned with maintaining their pax over a certain geographic space with no attempt to change or homogenize the ‘habits of the heart’ of their constituent communities; and the homogenizing empire, as best illustrated by the Chinese who created a fictitious homogenized Han identity out of the ethnically diverse people they incorporated. In our day the best example is the USA, which has created a homogenized American identity through its ‘melting pot’ of diverse races and cultures. Then there are the ‘nation states’ of the Renaissance princes, the UK, France and Spain which used mercantilist devices to incorporate different groups into a ‘nation’. It is

this last model that the African elites seemed to be following after independence, and with charismatic leadership there seemed some hope that they might have succeeded. But, given their resource endowments, the inevitable politicization of rents in states with continuing tribal and other ethnic rivalries has led to civil wars. In fact there seems to be an emerging statistical law about civil wars, which shows that there is an inverted U-shaped relationship between ethno-linguistic fragmentation in a state and the risk of civil war, the most homogenous (with every group with its own state) and the most fragmented (as in a multi-ethnic empire) being at least risk of civil war.<sup>8</sup> In this case the idea that constitutions and democratic forms could provide a corset to contain the bloody conflicts to capture the state and the booty that affords is laughable. Much better to either reconvene a new Congress of Berlin – run by Africans – to re-create tribally homogenous states, which, as the shining example of Botswana shows, could prosper, or else hope that some African state will establish a multi-ethnic empire and its pax over much of the continent!

Nevertheless, a number of cross-sectional statistical studies claim to have found a relationship between democracy and development.<sup>9</sup> But the statistical proxies used for the political variables in these studies do not inspire much confidence, which are further plagued by the econometric problem of identification. The two countries studied in this book, where democratic regimes supposedly replaced predatory authoritarian regimes – Haiti and Zambia – do not provide much confidence in this view. In fact, in our 1996 book, Myint and I found no relationship between the form of government and economic performance during the thirty-year economic histories of the twenty-five developing countries that we studied. Rather than the polity the initial resource endowment, in particular the availability or lack of natural resources, was a major determinant of policies which impinged on the efficiency of investment and thereby the rate of growth (as noted in section 11.1). The difference in performance was further explained by the other major determinant of growth – the volume of investment. Thus whilst the efficiency of investment in India and China during both their *dirigiste* and more economically liberal periods was about the same, China's investment rate has been about twice India's, resulting in its growth rate also being twice as high. This might be taken as providing some support for the view that democracies will have very high rates of time preference as compared with dictatorships. But considering dictators like Mobutu of Zaire or Marcos of the Philippines it would be difficult to sustain this view.

### 11.3

Finally, let us examine the effects of the current episode of globalization on economic policy making in developing countries. There is a view that globalization will lead to the withering away of the State. This view is as

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unjustified as the hope of the Marxists that their Communist paradise would lead to a similar – for them desirable – outcome. Two points need to be emphasized.

First, integrating with the world economy is still a matter of choice for every state. The reason so many are increasingly treading this path is due to the unparalleled popular opulence this offers. Some like Cuba and North Korea have chosen to turn their backs on the global economy with predictable dire outcomes for their populace. Nor is there something new about globalization. In the past it has been associated with the creation of empires which have brought hitherto disjointed economic spaces into a common economic area under their pax which has allowed the gains from trade and specialization emphasized by Adam Smith to generate what I call Smithian intensive growth. But these periods of globalization are not irreversible, as witness the nineteenth-century liberal, international economic order created under British aegis, and which was destroyed on the fields of Flanders.

Second, the processes of globalization, in particular the integration of capital markets, does increase the contestability of both states as well as corporations. For the degree of contestability depends, in both cases, on the barriers to entry and exit for potential new entrants and existing customers. Current fears that a globalized economy will be monopolized by large multinationals are thus unfounded, as globalization by increasing contestability will make even the largest of this species behave in a competitive manner.

Similarly the predatory state (in all its forms) will find that globalization will force it to reduce the net 'revenues' it can extract from its populace for its own purpose. Ideally, it will force them to act like the Platonic guardian state which only taxes its citizens enough to provide the essential public goods with a balanced budget.

Finally, in a globalized world, size does not matter, as long as the global public good of defence against external predators is ensured by a global hegemon. In parts of the world, for example much of Europe where this external threat has almost disappeared, we are witnessing the unravelling of the ancient 'nation-states', such as the UK. For many developing countries such a happy outcome is unlikely, partly because of the reluctance of the current hegemon – the US – to enforce its PAX if it requires it to expend its own men and material – though with the US reaction to the savage events of 11 September 2001 this seems to be changing. So in much of the Third World where the old impulses for territorial aggrandizement are not extinct, this reason to maintain a national identity coterminous with the territorial nation state will remain, and hence the 'nation-building' impulse which fuelled much dirigiste neo-mercantilism will remain in place. But to the extent that globalization forces the depoliticization of political life, it also makes it less important to capture the levers of economic power to make a living for oneself or one's

constituents. This means that domestic politics will need to cater less to the economic interests of particular groups, and could become less fissiparous. The state can then more easily become a 'civil' rather than an 'enterprise' association in Oakeshott's terms. This should reduce the tensions between a national identity fostered by the external threat and that belonging to a particular caste, tribe or other narrow group seeking to garner more of the gains in the political redistributive game for itself. All this of course assumes that there is a functioning state in the first place. For the failed states – of which Haiti provides the most vivid and tragic example in this book – until a viable state is created by the two routes outlined in the last section, globalization in itself offers no panaceas.

### Notes

- 1 Also parts of the essay are based on Lal (1998b) and (1999a).
- 2 On this interpretation of the origins and persistence of the caste system in India see Lal (1988). For Russia, the fact that serfdom was instituted to provide a surplus for the nobility is attested by two facts:  

the first ... [is] the replacement of the basic land tax by a household tax in the 17th century and a poll tax under Peter the Great. The second is ... [a] cultural trait ... as late as in the first half of the 19th century, the social position of a Russian landowner ... depended less on his landholding ... than on the number of souls (registered male peasants) he owned.  
(Domar, 1970, p. 232)
- 3 See Solow (1991) and Engerman and Sokoloff (1994). For evidence on the substantial economies in producing certain crops on large slave plantations see Deer (1949), Engerman (1983) and Fogel (1989).
- 4 See Kupperman (1993).
- 5 But there was also a more positive aspect of the common Catholic culture of Latin America. As Hugh Thomas has rightly pointed out to me, Latin America succeeded 'socially' where the US 'failed'. This was in part due to the planned cities, the skilful approach to racial matters enabling manumission of slaves, and of course a common Catholic culture which left their personal and social mores closer to the 'communalist' ones of the other great ancient civilizations than those based on the new fangled 'individualism' of their Protestant brethren. (see Lal, 1998a).
- 6 Veliz (1994) contrasts this universalism of Latin America with the greater tolerance of diversity in beliefs in North America as between the Baroque hedgehogs of the South and the Gothic foxes of the North in the New World, reflecting Archilochus' maxim: 'the fox knows many things, but the hedgehog knows only one thing', (quoted in Berlin, 1978).
- 7 See, for instance, Castaneda (1995).
- 8 See Collier and Hoeffler (1998).
- 9 See Przeworski and Limongi (1993) for a survey. The best of these studies is by Helliwell (1992), and the most cogent critique of the econometrics involved by Deaton and Miller (1995).

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