POLITICAL STABILITY AND ECONOMIC GROWTH: SOME CONSIDERATIONS

Rosario Cervantes*
Jorge Villaseñor**

ABSTRACT

The political instability events observed in major parts of the western world, in some Northern Africa countries as well as the Middle East in the so called Arab Spring in 2011, either were influenced by the most recent world financial crisis or affected the recovery process of economic activity. In this essay, the relationship between political stability and economic growth is revisited in order to contribute to the debate on the necessary actions to improve the reach of public policy in the long run.

* Universidad de Guadalajara / email: mariac@cucea.udg.mx
** Universidad de Guadalajara / email: jorge.ignacio@redudg.udg.mx

INTRODUCTION

> *"While Cairo was soaked in tear gas clouds from dozens of cans shot by the riot police into the crowd, it seemed like the regime was nearing an end. None of those who were this Friday in the streets of Cairo even knew were Mubarak was. And I could not find anybody that cared about it" Robert Fisk, The Independent (published in La Jornada, Saturday 29th of January of 2011)*

From 2010 until the end of 2012 the world observed a series of recurring demonstrations of social discontent towards regimes and public policies. London, Paris, Rome, Cairo, Athens, Tunis, and Santiago, were some of the cities in which demonstrations turned violent. The proximity and magnitude of these events to the world financial crisis that started in mid - 2007 in the United States and that expanded throughout the rest of the world in 2008 and 2009, makes us reconsider the existing relationship between the economic performance of nations and their political and social stability. This is especially important since the most recent financial crisis forced many governments to modify their expenditure plans and, in general, their economic policies. In Greece the demonstrations were against budget cuts aimed to avoid some of the deeper effects of the crisis. In London, Paris and Rome the demonstrations were against more specific reforms such as increases in tuition fees, reforms to the pensions systems and reductions in education spending. In Tunis and Cairo, besides demonstrations in countries such as Yemen, Bahrein, and the civil war in Libya and Syria, demonstrations were against the entire regime. The latter were the countries involved in the so called Arab Spring and those were the ones in which demonstrations turned more radical and towards which governments reacted more violently. As for Tunis, these demonstrations were the main cause for former president Ben Ali, who headed the government from 1987 to 2011, to resign and flee the country; likewise, in Egypt, even though demonstrations lasted longer, President Hosni Mubarak quit on February the 11th of 2011 after more than 30 years as head of the Egyptian government.[1]

Even when it is farfetched to assert that the recent demonstrations from society are a direct consequence of the poor performance of their national economies or the effects of the recent world financial crisis on production and employment, it is worthwhile to ask what would the likely effect of these social movements in the future performance of the economies involved be like. The literature on the relationship between political and social stability and economic growth acknowledges that they are variables that determine mutually. Economic performance de-

1 Fisk, R. (2011a) "Estalla júbilo por la renuncia de Mubarak", La Jornada, February 12th 2011.

pends on political stability and the latter depends on the behaviour of key economic variables. Economic growth, income distribution inequality, inflation, poverty levels as well as fiscal and monetary policy decisions are variables that influence political stability, besides some other socio-economic variables.

The main purpose of this essay is to present an up to date picture of the political stability indicators published by the World Bank in the *Worldwide Governance Indicators* and their relationship with some of economic variables and other governance indicators [2]; as well as to contribute to the debate on what to do if economic growth with political stability is the goal to achieve.

The political stability and non-violence index that will be used, according to the World Bank definition: "*Reflects perceptions of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including politically-motivated violence and terrorism*". However, according to Alesina and Perotti (1996: 1205), there are two ways in which political stability is conceptualized: a) according to the relationship between the execution of power and "the propensity to observe changes in the government", by unconstitutional means or even in a legal way, and b) according to the levels of social unrest and political violence. Hence, political stability, besides representing a lower probability for the government to be overturned, it is considered as a set of conditions that allow governments to make economic policy decisions according to their plans.

In section two, a brief summary of the theoretical arguments, in which the idea that less political stability has a negative impact on economic growth rates rests, is made; and that political stability depends on economic growth, income distribution inequality, inflation, poverty levels as well as some other socio-economic variables.

In the third section, an analysis of the behaviour of the variables with which the World Bank constructs the governance index for the period 1996 – 2009 is made, and simple correlation tests between political stability levels, GDP growth and GDP per-capita, are performed. In the fourth section, a brief discussion is made regarding the type of strategy that countries should fol-

2 In this text we refer to governance and its indicators from the World Bank definition found in the Worldwide Governance Indicators: "Governance consists of the traditions and institutions by which authority in a country is exercised. This includes the process by which governments are selected, monitored and replaced; the capacity of the government to effectively formulate and implement sound policies; and the respect of citizens and the state for the institutions that govern economic and social interactions among them." (World Bank, 2013)

low in order to grow faster at the same time that their institutions and social and political stability recover; from the latter, the idea is that a successful policy design cannot be the one in which a "trade-off" or "sacrifice" between political stability and economic growth must be made; since they are mutually determined, the necessary economic policy design for economic growth must match the public policy design that, in general, seeks to increase political stability levels. Concluding remarks are presented in the fifth section.

1. SOME THEORETICAL FOUNDATIONS ABOUT POLITICAL STABILITY AND ECONOMIC PERFORMANCE

According to Haan and Siermann (1996), since Adam Smith to date the importance that political and social stability has on economic performance has been discussed. The main argument that holds the idea that political stability is a necessary condition for the optimal functioning of the economy is, in fact, very simple: in a capitalist economy, with private means of production, it is necessary for governments and their institutions to guarantee the right to own and increase the wealth of economic agents. If governments are not capable to guarantee the rights over private property and the output of labour, the investment decisions will be affected by uncertainty, reducing available aggregate savings given the increase in money hoarding[3], capital flight, or even by the increase in present consumption in order to overcome potential shortages in goods (Carmignani, 2003; Gupta, 1994; Gupta y Blee, 1998; Svensson, 1997). Furthermore, governments act as intermediaries for any existing conflicts derived from any form of contract between two private agents, even if property rights are not compromised, (Gupta, 1994).

On the other hand, any sovereign government can, through its fiscal and monetary policies, affect economic performance as a consequence of a reduction of the political stability levels. In democracies, political

3 Money hoarding for the purpose of this essay must be understood as the quantity of money that economic agents hold in cash or save outside the financial system, as a consequence of the uncertainty generated due to political instability.

instability[4] can provoke significant changes in public expenditure and taxation as well as in the structure or distribution of such expenditure and taxation levels, besides changes in monetary policy or even variations in the depth of public deficit; either as measures to avoid changes in the shares of power of the ruling political party or to impose obstacles to the incumbents (Carmignani, 2003: 2). On the other hand, in non-democratic governments certain levels of political stability can be guaranteed, in the short run, not only by relatively higher expenditure in law enforcement in order to maintain the peace but also trough redistributive fiscal policies or social and infrastructure programs to attend the most urgent needs of the population. Hence, as a consequence of political instability, or even as a side effect of possible social unrest, governments adjust their economic policy decisions that, in turn, have an impact in general economic performance.

Therefore, there are two main channels through which political stability favours economic growth, both in the short and long run: a) through the private agents, due to the certainty derived from political stability and, b) through the government and its economic policy decisions.

Figure 1 shows the main channels through which political stability can positively affect economic growth. As mentioned earlier, through the private agents the likely effects of increases in social and political stability are observed as a consequence of certainty. Three main channels can be observed: 1) less certainty diminishes the expected return rate of investment and, therefore, investment diminishes and growth falls; 2) less certainty means less aggregate savings as a consequence of money hoarding and/or an increase in present consumption levels that reduce the amount of available loan funds, investment and aggregate demand and; 3) a reduction in political stability affects the labour market and the productivity/production levels due to strikes or factory closures that in turn will affect revenues and therefore the investment levels.

4 The majority of the research on the subject uses the term "social and political instability" instead of "political stability", nonetheless, for this essay, both terms can be used since they are not mutually excluding.

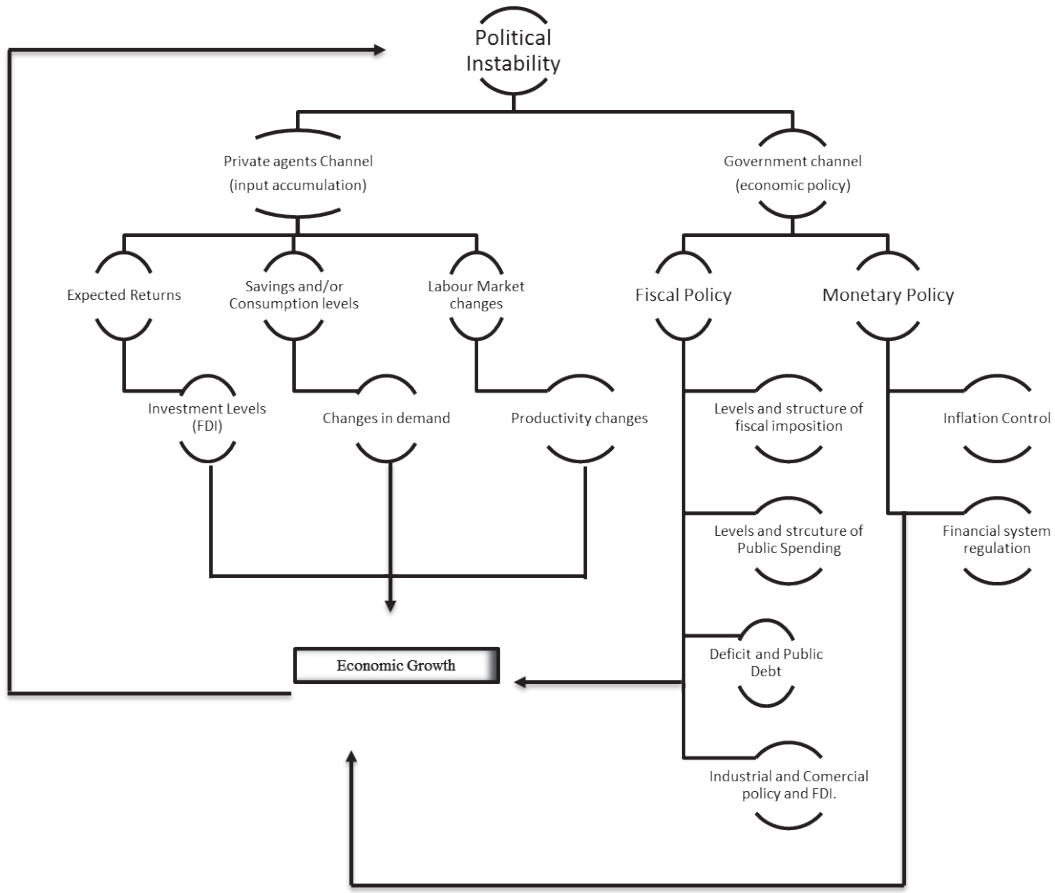

Figure 1. Political Stability and Economic Growth.
Source: Own creation.

Stability can indirectly affect economic performance through monetary and fiscal policy decisions. As an example, in the case of monetary policy, it is considered that inflation control is a necessary condition to obtain economic growth, and it is also assumed that in the presence of political stability, governments are less likely to take control of the central bank and make discretionary decisions about changes on money supply that can affect inflation levels and expectations and, thus, investment decisions. As for the fiscal policy, political stability contributes to explain the absence of discretionary decision making in regards to public expenditure and taxation. Hence, either directly through the decisions of private agents that induce changes in investment levels and money hoarding, or indirect-

ly through economic policy decisions: if an increase in political stability induces an increase in the economic growth rate, the latter in turn can derive in higher levels of political stability. In other words, a virtuous circle between political stability and economic growth or vicious circles between poor economic performances and political instability can be generated. The following sections provide more detail on the relationships described in figure 1.

1.1 CERTAINTY, INVESTMENT AND ECONOMIC GROWTH

Political stability levels and economic performance are mutually determinant given the certainty that a stable political and social environment provide to economic agents which, in turn, decide whether or not they invest in capital goods or money hoarding; while for the government, in the presence of stability and certainty, its decision are not discretional or circumstantial.

On the one hand, among the economic factors that may affect political stability are income distribution inequality, especially if, as an economic phenomenon, this inequality is not transitory. Furthermore, high unemployment and inflation rates and low economic growth are also variables that represent a risk for governments. On the other hand, the political factors that affect political stability will be regarded as the rest of the variables that the World Bank considers when constructing the governance index, (World Bank, 2013): a) *Government Effectiveness*, b) *Rule of Law*, c) *Control of Corruption*, d) *Regulatory Quality* and, e) *Voice and Accountability*. In other words, alternatively to the work done by the World Bank in which a governance index is estimated using the variables mentioned above plus political stability, here political stability is considered to be strongly determined by these variables.

In the discussion on the subject, it is also considered that democracies tend to be more politically and socially stable since the possibility of having an influence trough voting, demonstrations and other forms of social participation is a good relief mechanism for any political or social frustration; this in turn, allows investors to attain more certainty regarding the ownership of their assets and the revenues derived from their economic activity. Nonetheless, in the long run, if the current political system of democratic nations is not capable of giving any solutions that enhance the economy and improve social and economic justice, it will be the economic variables the ones that will reduce the levels of political stability. In other words, there is a bigger chance of governments to be overthrown, either through constitutional means (i.e. anticipated elections), or through violence (i.e. civil war or military coup)

The experience of Latin-American countries that in recent years

have politically transformed themselves into democracies show how political stability can be diminished after more than two decades (in average) of economic policies that have not been able to reduce income distribution inequality, unemployment rates, and attain greater growth rates[5]. Only through a relative inflation control, a relative reduction of exchange and interest rates volatility; besides fiscal deficit reductions have been attained as a consequence of the structural reforms that implied freer goods and services markets, less financial systems regulation, and in general less government intervention in the economy (French-Davis, 2005). Thus, even though countries have freer and more democratic regimes, the slow economic growth that the vast majority of Latin-American countries have experienced, together with high unemployment rates and the persistent income inequality, have derived in the region witnessing different types and magnitudes of political instability. Among the countries in the region for which political stability was reduced are Bolivia, Ecuador, Brazil, Nicaragua and Venezuela, in which social unrest derived in a significant change of the political orientation of those governments who favoured a more active participation of the state in the economy. Furthermore, countries such as Mexico, Colombia and some other Central American nations, are beginning to show signs of political and social instability as violent crime and government corruption associated to organized crime are more evident.

As for non-democratic regimes, in the short run, high levels of "political stability" can be observed since social demonstrations, or in general, any civil disobedience measures that threaten the stability of government do not occur. However, in the long run, dictatorships or any other form of non-democratic ruling tend to face political instability processes far more violent and with deeper consequences in the short and long run growth rates.

Hence, regardless of the type of government, political stability variations have a visible impact in the performance of national economies through changes in the levels of certainty of private agents, who face less future revenues in the wake of a greater risk associated to political stability reductions.

5 An special case of a nation that achieved a democratic rule of law after years of dictatorship is Argentina that just in 2001 saw four presidents taking office: Fernando de la Rúa, who resigned; Ramón Puerta, who quitted in favour of Adolfo Rodríguez Saa (elected by the parliament), who resigns and is succeeded by Eduardo Camaño. Even though all these changes occurred in a short time period and are made through constitutional channels, what is worth noticing is the fact that the resign of Fernando de la Rúa, elected in October of 1999, is was a direct consequence of social unrest and poor economic performance.

Gupta (1994) derives a multiplier for a "basic Keynesian macroeconomic system" in order to show how political instability affects general equilibrium. The analysis is derived from the assumption that individual's income is not only distributed among savings and consumption and a third variable called money hoarding is added and it depends on the political instability level. Less political stability means people increasing money hoarding - more monetary income is retained in the form of cash due to uncertainty since a trade-off between income and present consumption is favoured, the latter reducing savings since there is no certainty of the future. Hence, directly, less political stability reduces available lending funds in the financial system and fewer investments are made. Furthermore, depending on the type and magnitude of the reductions in political stability, a drop in the return rate of investment is observed due to increasing uncertainty. With higher political instability levels the greater the probability of private economic agents observing a significant loss in their assets, output or revenues due to illegal or illegitimate expropriation and therefore investment levels drop. Finally, according to Gupta (1994), a slower economic growth can also be derived from changes in aggregate supply that change equilibrium output levels as a consequence of political stability variations effects on the labour market: when political instability appears in the form of strikes, rioting or hostile takeover of factories and production facilities, productivity and the total levels of production fall.

1.2 ECONOMIC POLICY AND GROWTH

If political stability is defined as the probability of a change in the government and the possibility that is able to execute power effectively, here is argued that a second channel trough which variations in political stability affect economic performance is through the policy making process of the government. The latter under the assumption that given different scenarios of political instability can be associated to different economic policy designs: if the government observes that a given policy design assures continuity this can in turn have either a positive or a negative impact on growth.

Even though there is no theoretical consensus about the way in which a given economic policy design affects growth rates in the long run, in this section a brief discussion is made on what is commonly expected to occur in the economy when governments undergo specific decision making on expenditure and taxation levels and commercial and industrial policy, among others.

Hence, some of the more relevant hypotheses on the relationship between economic policy and growth, both at the empirical and theoretical level, are:

a) More public expenditure will translate in higher growth rates through the multiplier effect as established in the Keynesian macroeconomic models. Or, public expenditure can positively affect growth if, as an example, public investment on infrastructure favours the economies of scale and accumulation, or generates positive externalities that increase private investment (crowding in). Although there is also theoretical approaches that consider the aggregate supply function as the one determining the long run growth pattern and that fiscal policy has no effect on production and employment levels in the long run. Hence, any increase in public expenditure either financed through taxes or public debt will only represent an investment made by the government (crowding out), thus, the effect of increasing public expenditures on growth would be null. Besides, if expending increases by increasing the monetary base this could lead to an inflationary process that would hinder long run growth6.

b) It is also said that a redistributive fiscal policy can diminish economic growth since the marginal propensity to save is greater for higher income households, aggregate saving levels would be reduced and consequently investment would fall. Particularly, Kaldor (1960), considers that income distribution inequality is positively related with economic growth since owners tend to save a larger share of their income than workers. Thus, implementing progressive income tax rates can reduce investment levels and economic growth due to a reduction in aggregate savings.

c) On the other hand, it has been stated that economic policy directed towards deregulation of goods and ervices, financial and assets markets, lead to a more efficient resource allocation and to higher economic growth rates. This is, promoting economic activity through deregulation in highly competitive environments should lead to a more efficient distribution of resources and higher productivity and employment rates would be observed.

6 For a more thorough discussion on the effects of financing public deficit on growth see Friedman (1978).

d) Also, it is said that an industrial policy focused in supporting strategic sectors of the economy (high added value manufacturing) can boost long run economic growth. Specially, in import substitution models, it is argued that temporal protection of strategic sectors promotes growth through the multiplier effects that economic activity has in the private sector by demanding intermediate inputs. The same results are expected when the development model is based on promoting exports that will generate the necessary currency to finance the rest of the economic activities that require imported inputs.

Furthermore, in Rodrik (2005) the following hypotheses that have been tested through cross section econometric models can be found:

a) A restrictive monetary policy to keep inflation low and stable favours economic growth in the long run since it generates a certainty environment over the investment revenues.

b) A monetary policy with an appreciated exchange rate also favours economic growth since allows developing economies to import capital goods and boost economic activity in greater added value sectors and more competitiveness is achieved.

c) State ownership of financial institutions hinders economic performance and, therefore privatization processes should lead to higher economic growth rates given a more competitive environment.

Even though there is a wide range of hypotheses on the relationship between economic policy and growth, what matters for the purposes of this essay is that the relationship between political stability and economic performance can also be observed through the policy making process. The latter since, either governments make (good) policy decisions in order to increase stability levels while diminishing the effects of a high propensity to government changes on the economy (through the decision making processes of private agents) or governments make (bad) policy decisions that negatively affect economic performance, which in turn will diminish political stability levels; economic performance and political stability are mutually determinant.

The latter, in econometric forecasting is known as "joint endogeneity" and implies an important obstacle for the estimation of unbiased parameters. For example, Alesina et al. (1996) and Zureiqat (2005) conduct test to determine the presence of joint endogeneity and in both cases the double causality hypothesis between political instability and economic growth is confirmed. However, in this essay the goal is not to perform a

thorough structural analysis on the determinants of political stability and economic growth; the latter been the reason why, in the following section, an analysis of the evolution of the World Bank *Political Stability and Absence of Violence/Terrorism index*, other governance indicators and standard measure of economic growth: GDP and GDP per capita growth rates, is presented. The latter with the joint objective of reviewing what happens at the country and individual level; simple averages by country and weighted averages by population size will be presented. Furthermore, an analysis of grouped data for countries listed according to their per capita income levels will be made.

2. POLITICAL STABILIY AND ECONOMIC GROWTH, 1996-2009

Alesina y Perroti (1996) in a paper titled "Income distribution, political instability, and investment", argue that one of the channels through which income distribution inequality negatively affects investment levels and economic growth, is political instability. The latter since with higher inequality levels social unrest increases and the probability of demonstration, civil disobedience and the like[7].

However, Carmignani (2003) find that out of 27 empirical studies on the subject only 51.8% of them show evidence in favour of a negative impact of political instability on economic growth. In the 40.7% of the studies non-significant result are obtained and just 7.4% shows a positive relationship but under certain restrictions. Particularly, in the work of Fosu (2001) in which a cross section analysis is made out of a sample of developing countries, the correlation between political instability and economic growth is indeed positive; however, by allowing interactions with variables such as physical capital the relationship between political stability and growth becomes negative; hence, when controlling for differences among countries with other kind of indicators the negative relationship between stability and growth is confirmed. In Campos and Nugent (1998), using panel data and a political and so-

7 The movement "Occupy Wall Street" which formally started on the 17th of September 2011 has precisely as one of its main drivers to protest about the huge income inequality. With the slogan "we are 99%", the movement highlights that the remaining 1% of Americans with higher incomes "accumulate a quarter of total national income" and in "terms of wealth instead of income, this 1% controls 40%" (Stiglitz, 2011).

cial instability index for a time period of five years, the authors find that while the effects of political and social instability is positive for investment (and that in the sense of Granger causality goes from instability towards investment) the latter can be due to the fact that instability can "delay" investment, or that instability destroys physical capital, or even more, less stability levels can derived in changes in government policies that will have a positive impact on investment. Furthermore, the way instability affects growth depends not only of other economical or institutional factors but on the magnitude of social unrest demonstrations and on the fact that the likely effects of an increase of instability levels may be observable I the short, medium and long run.

Besides the likely effect that income distribution inequality –and other economic variables- has on political stability, the general performance of governments and their institutions also explain the levels of political stability. Corruption is a problem that, when generalized, provokes social unrest, so that governments that are not capable of controlling such corruption levels affect not only the transaction costs but social and political cohesion, identity and stability. An efficient State in which the rule of law is observable, dialogue exists and civic participation is allowed when making policy decisions will be a State with less political instability. In figure 2 and table 1 simple and weighted for population size averages of the 7 sub-indexes for governance for the time period 1996-2009 can be observed. Each indicator is defined to take values between -3 and 3 implying that every time and indicator approaches the higher limit the better government performance is. As can be seen in 5 out of the 7 indexes averages have negative values.

Even though, in general, the world average of the *Government Effectiveness* index tends to be positive for almost all countries, is worth noticing that the averages of the rest of the indicators are negative for almost all sample sizes selected: 199 (total of countries listed in the data base of governance indicators), 149 (countries for which data is available for the whole time period), 147 (without China and India) and 61(analysis sample to compare the rest of economic variables).

If political stability can be explained as the result of the interaction of multiple economic, social and political variables, for figure 2 and table 1 it is noticeable that the average of the *Political stability and non- violence* index is significantly lower when weighted by population size, which indicates that the majority of inhabitants of the planet live in political uncertainty conditions or of open violence. The latter is maintained even if China and India are excluded from the sample. On the other hand, the *Participation* index weighted by population size is indeed significantly higher when China and India are included since, together, account

for almost a third of world population. Nonetheless, the influence that the Peoples Republic of China could have when calculating weighted averages, the distance between the *Political stability and non-violence* index with the rest of the governance indicators must be highlighted; this is, such distance is assumed to be a consequence of other economic and social variables behaviour and not only of governments quality, whether they are democratic or not.

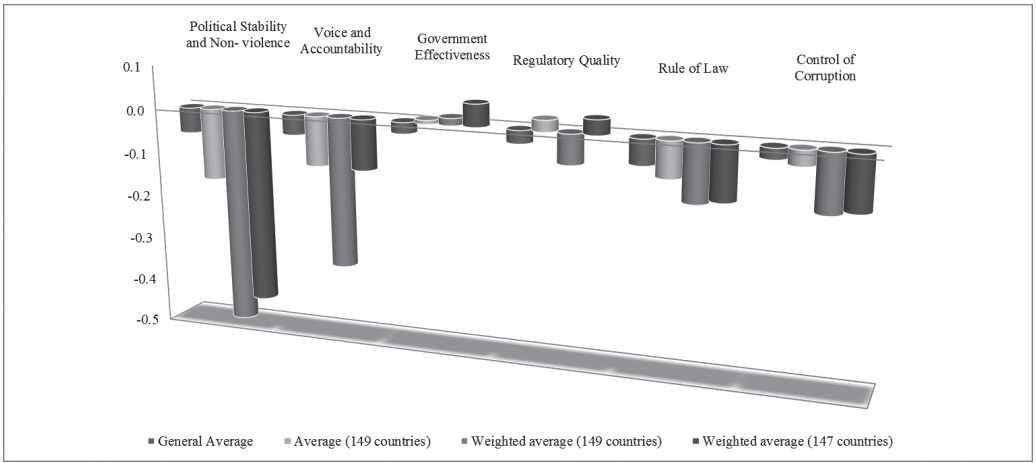

Figure 2. Governance indicators, 1996-2009 (averages).
Source: Own based on World Bank Data.

TABLE 1. GOVERNANCE INDICATORS, 1996-2009 (AVERAGES).

	Political Stability and Non- violence	Voice and Accountability	Government Effectiveness	Regulatory Quality	Rule of Law	**Control of Corruption**
General Average	-0.057	-0.045	-0.025	-0.029	-0.056	-0.024
Average (149 countries)	-0.162	-0.112	0.008	0.026	-0.080	-0.034
Weighted average (149 countries)	-0.491	-0.339	0.016	-0.067	-0.128	-0.128
Weighted average (147 countries)	-0.438	-0.114	0.050	0.034	-0.121	-0.121

Source: Own based on World Bank Data.

On the other hand, the tendency of the governance indexes do not show a clear pattern towards better governments for the time period selected. The *Political Stability and non-violence index*, even when is relatively stable in its general averages for the 149 countries sample, shows more variations in its averages weighted by population size with a light tendency to higher political instability levels (Figure 3).

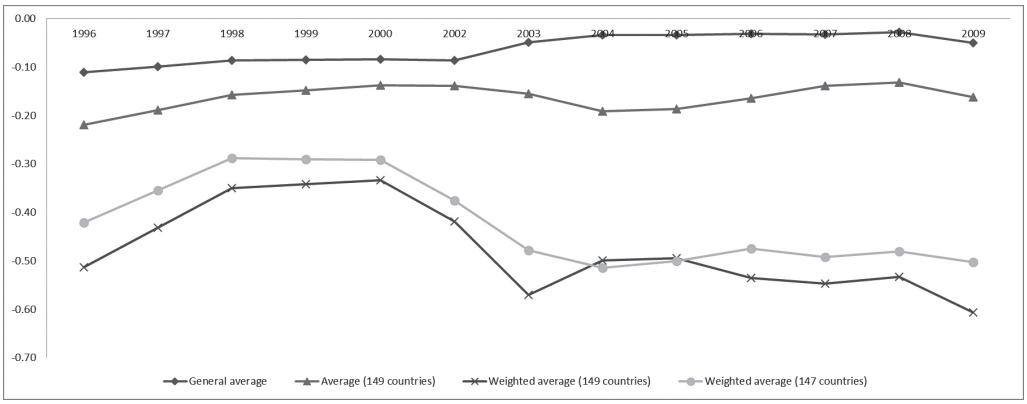

Figure 3. Political stability and non-violence, 1996-2009.
Source: Own based on World Bank Data.

Along the whole time period selected, the general average of the *Corruption control* index is stable and in a negative values scale. Besides, as for the weighted averages by population size it can be observed that I the more highly population countries corruption has even become a bigger problem, the latter even when excluding China and India from the sample. For the rest of the indicators: *Participation, Government effectiveness, Regulatory quality and the Rule of law,* there is also not a clear tendency towards more efficient governments.

As for other economic indicators, an analysis is presented, grouping countries by income per capita levels, GDP rates behaviour, GDP per capita, GINI index and other variables for the 61 countries sample with the most available data[8].

In table 2, a summary of some relevant characteristics of the countries from the sample can be found. Firstly, the 61 countries population represents 78% of world total population in the year 2000. By number of countries the sample would be biased towards the

8 The list of countries included can be found in the document's annex.

high and medium - high income countries and that together would represent 62% of the sample but only 30% of world population. However, most of the sample population live in countries with medium- low income (almost 64%). By income level, the least representative group of countries is the low- income group due to the lack of available data for these regions.

On average, the GDP of the countries in the sample represents 77% of world GDP and most of it concentrates in high income countries: 77.3% of GDP of the countries contained in the sample. In terms of income per capita there is a significant gap between high and medium income countries, in average, for the whole time period, income per capita for the high income countries was 26,074 US dollars while for the medium income countries the income per capita average was 3,928 US dollars of the year 2000. This is, for every 100 US dollars of income per capita in the high income countries, in the medium, medium-low and low income countries, in average, 15.1, 3.7 and 1.2 dollars were attained respectively. Furthermore, according to the *Democracy Ranking* (Democracy Ranking Association, 2012), there is still a strong correlation between de democracy index and income levels.

TABLE 2. CHARACTERISTICS OF A 61 COUNTRIES SAMPLE.

Income level	High	Medium - High	Medium-Low	Low	Total sample	Total
Number of Countries	21	17	18	5	61	199
	34.4	27.9	29.5	8.2		31%
Populationa	752	708	3,015	261	4,736	6,059
	15.9	15.0	63.7	5.5		78%
GDPb	20,070	2,861	3,044	87	26,062	33,836
	77.3	11.0	11.4	0.3	100	77%
Per capita incomec	26,074	3,928	975	314	5,366	5,525
	100	15.1	3.7	1.2		
Democracy indexd	78.0	60.0	49.1	44.0	55.0	

Source: Own based on World Bank (2013) and the Global Democracy Ranking (Democracy Ranking Association, 2012)-

a) Millions of individuals for the year 2000.
b) Billions US dollars of 2000, simple average 19996-2009.
c) Average 1996-2009, weighted by population percentage.
d) Index composed of variables measurements such as "political rights", "civil rights", "press freedom", "gender gap" and "corruption perception index", etc.

Regarding the GINI coefficient, the Stability and non-violence index, annual total GDP growth rates and GDP per capita- for the time period 1996-2009- in table 3 simple averages and averages weighted by population size are presented. The high income countries are the ones that tend to have less income distribution inequality; while the medium-high and medium-love income countries have the higher GINI coefficients. With the available data for the sample size, both for the simple averages and the averages weighted by population size a Kuznets "inverted U" relationship can be observed; the latter showing that, starting from low income levels, inequality grows as income increases, it then reaches a maximum point to then start declining, (Kuznets, 1955).

TABLE 3. INEQUALITY, STABILITY AND ECONOMIC GROWTH, 1996-2009, (AVERAGES BY INCOME LEVEL).

	High	Medium-High	Medium-Low	Low	Total
Gini Coefficient	29.8	46.6	45.1	37.3	39.7
	-35.8	-48.1	-39.5	-33.6	-39.9
Political stability and Non-violence	0.9	-0.2	-0.6	-0.8	-0.2
	(-0.7)	(- 0.5)	(- 0.6)	(- 1.0)	(- 0.4)
GDP growth	2.6	4.1	4.2	5.5	4.1
	-2.3	-3.3	-7.2	-5.6	-5.7
Per capita GDP growth	2.1	3	2.5	3.4	2.8
	-1.6	-2.4	-6	-3.5	-4.6

Source: Own using World Bank data and UNU-WIDER World Income Inequality Database.
Note: values in the parentheses represent weighted averages by population size.

As for the grouped data by income level, in average, a positive correlation between incomes per capita and the Political stability and non-violence index can be observed. Hence, for the sample size is confirmed that most of the world population tends to live in in countries with less political stability.

In table 3 it can be seen that, in average, high income countries registered the lowest total GDP and GDP per capita growth rates, while the low and medium-low countries tend to have the highest economic growth rates, especially when weighted by population size growth rates averages are taken into consideration.

Summarizing, the annual averages for the grouped data do not show a positive correlation between political stability and economic growth, since the countries with the higher growth rate for the time period of analysis are the same that show the lowest Political stability and non-violence index levels. Nonetheless, with the data grouped in such a way it is not possible to observe if political stability changes have an effect on economic growth rates and vice versa.

In figure 4, four simple correlation tests between economic growth and political stability; income distribution inequality and political stability; per capita income levels and political stability; and GDP growth and political stability, are presented. The first two regressions show that both economic growth and income distribution inequality would have the kind of correlation expected, positive changes in economic growth rates lead to positive changes in political stability and higher levels of income distribution inequality lead to less political stability for the 1996-2009 time period. However, in both cases the correlation is relatively weak. Instead, the third and fourth regressions show a strong correlation between GDP per capita levels and political stability and between GDP per capita growth rates and political stability levels. The latter confirming, the results obtained using the grouped data by income level and

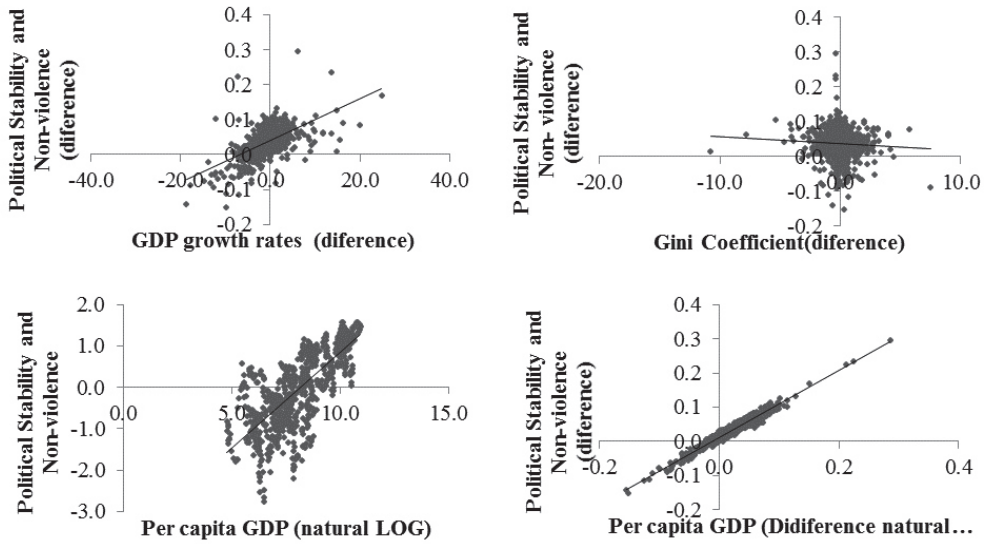

Figure 4. Political Stability, GDP Growth, Income Distribution Inequality And per capita GDP, 1996-2009.
Source: Own based on World Bank Data.

Finally, in table 4, by income level, simple averages and weighted by education expenditure as a proportion of GDP, gross savings and gross domestic savings and gross fixed capital formation also as a proportion of GDP are presented.; besides the annual growth rate of gross fixed capital formation. As expected there is a coherent correlation among both savings rates and capital formation with economic growth rates as well as between income levels and education expenditures, savings, capital formation and capital formation growth rates. This is, higher income countries invest more in education and save a large proportion of their income even though they have lower capital formation rates. As for the medium – low income countries they have the higher economic growth rate averages and the higher gross savings proportion, gross domestic savings rate weighted by population size and the gross fixed capital formation rates

The exception to this correlation patterns between savings, capital formation, income levels and economic growth can be found in the low income coun-

tries. The latter since, they tend to invest less in education even though their gross savings as a proportion of GDP (weighted by population size) is higher than that in the high income countries; furthermore, even when these countries don't have the highest economic growth rates they do have the higher gross fixed capital formation growth rates. This lack of consistency is assumed to be due the fact that these same countries are the ones that show the lower levels of political stability and non-violence.

TABLE 4. EDUCATION EXPENDITURE, SAVING AND GROSS FIXED CAPITAL FORMATION, SIMPLE AND WEIGHTED BY POPULATION SIZE AVERAGES 1996-2009.

	High	Medium-High	Medium-Low	Low	Total
Education Expenditurea	5.0	3.6	3.4	3.7	3.9
	4.7	3.8	2.7	2.7	3.2
Gross Savingb	22.3	21	22.7	16.2	20.5
	19.2	21.2	34.5	23	29.5
Gross domestic Savingc	24.9	22.9	17.5	7.9	18.3
	19.9	23.1	33	12.4	28.3
Gross fixed capital formationd	21.8	20.8	22.4	20.2	21.3
	20.4	19.4	30.1	21.8	26.5
Crecimiento de la formación bruta de capitale	3.1	7	4.3	9.4	5.9
	2	4.8	8.8	9.2	7.2

Source: Own based on World Bank data.
a, b, c,d. GDP Participation Averages.
e. Anual average growth rate.

3. POLICY CONSIDERATIONS

From the evidence presented, it is possible to put forward a set of actions that countries should take into consideration if they want to achieve long run economic growth. Even when the specific policy design can indeed vary from country to country it is possible to identify certain common factors among nations that allow for the formulation of some policy recommendations. Particularly, the importance of having proportion

of expenditure destined to strengthen the Governance Indicators of the World Bank must be highlighted.

Hence, in order to increase political stability, and therefore, contribute to the increase of economic growth rates in the long run, the participation, government effectiveness, regulatory quality and the rule of law indicators must be improved. The main idea is that, since the beginning, a strong will to increase the governance indicators must guide the whole policy making process. Adequate policies that improve the conditions that permeate in each and every one of the aspects mentioned above will help to lessen any negative impact on economic growth through the reduction of the possibility of alterations in the key economic variables that could reduce per capita income (or its growth rate). The latter justifying changes in policy making.

Lower political stability levels and their negative effects on economic growth would be attained by taking the following actions which are interdependent and not mutually exclusive:

1. Strengthen the Rule of Law so that the necessary mechanisms exist for agents to comply and trust society's rules and, in particular, the quality in contracts execution, property rights, law enforcement and the courts; as well as reducing the probability of crime and violence
2. Strengthen government structure in order to reduce the probability of the government to become unstable or overthrown by unconstitutional or violent means, including violence politically fuelled and terrorism.
3. Policy design that avoid the execution of public power for private benefit, including large and small forms of corruption as well as the "coup" of the State by private interest and elites.
4. Policy design directed to increase the quality of government services, quality of public service and the degree of independence from political pressures, quality in the formulation and implementation of policies and the credibility on the government`s commitment with such policies.
5. Actions directed to civic participation when choosing the government, freedom of expression, freedom of assembly and press freedom.
6. Strengthen the ability of the government to formulate an implement solid policies and regulations that allow and promote private sector development.

Finally, even though the apparent neutrality of public expenditure directed to the development of state and governance institutions, it is es-

timated that this kind of expenditure would not disturb the kind of expenditure that do have direct multiplying effects on the economy, the latter since, in reality, it is not expensive for governments to work on the improvement of their functions and because it is considered that a crucial aspect for political stability and peace is a better communication between government and society.

4. CONCLUSION

Even though the relationship between political stability and economic performance is relatively evident, since a frame of minimum normative security and validity of the government is needed to make commercial transactions and investments both in fixed capital and in speculation, on the one hand; as is necessary for economies to work fairly and efficiently for individuals to feel safe and social cohesion to persist, on the other hand; for many years this relationship was taken as given and both at the theoretical and empirical level the evaluation of the possible effects of one variable on the other was not reviewed.

Hence, since the late 80`s to date a re-emergence of the interest to measure the impacts of political instability episodes on economic growth is observed. The results obtained in this essay it is intended to discuss the present circumstances by taking the likely effects of the financial crisis that spread in 2008 on the political stability of the nations involved and, at the same time, the effects that these political instability increase would have in the recovery and the consequent economic growth.

With a sample of 61 developed and developing countries it is found that, for the 1996-2009 time period, the relationship between political stability and economic growth is positive and significant, especially when changes in per capita income and the political stability and non-violence levels are observed. Furthermore, it is also confirmed that for the same time period only countries with higher development levels tend to be more stable.

Therefore, it is argued that given the variables endogeneity, in the policy design to favour economic growth (or stability) there cannot be a trade-off that favour one objective by sacrificing the other, as well as no social stability policy design must be made by sacrificing economic recovery and growth mechanisms. Besides, it is also considered that the need of the economic policy design to be explicit rests in the need to strengthen the State institutions.

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APPENDIX A

COUNTRIES INCLUDED IN THE SAMPLE LISTED BY INCOME LEVEL.

High income countries	Medium-high income countries	Medium-low income countries	Low income countries
Germany	Argentina	Bolivia	Bangladesh
Austria	Azerbaijan	China	Ethiopia
Canada	Brazil	Ivory Coast	Kenya
South Korea	Bulgaria	Ecuador	Kyrgyzstan
Denmark	Chile	Egypt	Mozambique
Spain	Colombia	El Salvador	
United States	Costa Rica	Philippines	
Estonia	Malaysia	Guatemala	
Finland	Mexico	Honduras	
France	Panama	India	
Greece	Peru	Indonesia	
Hungary	Dominican Republic	Jordan	
Ireland	Romania	Morocco	
Italy	Russia	Nicaragua	
Luxembourg	Turkey	Pakistan	
Norway	Uruguay	Paraguay	
Netherlands	Venezuela	Thailand	
Portugal		Vietnam	
United Kingdom			
Czech Republic			
Sweden			