The effect of political leaders on economic growth through institutional change

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The article summarizes the influence of political leaders on institutions which, according to institutional economics, directly influences economic growth. Furthermore, the study reviews the literature in which leadership itself becomes a significant factor as a possible explanation for the reason for economic growth through institutional change. Although political leader or its role in growth is still viewed as a controversial issue in economics, the paper emphasises what kind of cause-effect relations exist between political leaders and economic growth and reveals that leaders do matter directly in economic performance by the formation of institutions.

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Introduction

Research on what brings an economy to grow has been a significant, but controversial issue for decades. Numerous economists ((*Acemoglu–Johnson–Robinson 2002, Olson 1996, North 1990, Rodrik 2007*) have identified myriad dimensions which may have effect on economic growth. Among explanations, I place leaders or leadership itself into

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the focus, i.e., leaders are capable of swaying the direction of growth by re-planning or forming institutions. It is often said that strong political leadership is necessary for economic development and, indeed, strong political leadership may even be good or bad for economic development. Almost everything depends on the kind of institutions, leadership groups and, of course, the kind of leader is serving in office. This article attempts to clarify these issues by looking more closely at these elements.

Both in demomcracies and autocracies, we can notice poor economic performances, so the question is whether modest output growth can be traced back to the personality of the leader or to his or her decisions. The study concentrates on what role the political leaders or leader's group have in economic growth and how it can be explained by a political economic approach. To understand the question of „how" I will use selected fundamental concepts and arguments from institutional economics. The role of institutions is crucial in economic growth, however, it is not the only factor. The leader and the leadership group are able to intervene into the evolutionary developement of institutions, which may alter the direction of the growth. After illustrating the relationship between institutions and economic growth, I will review the concrete methods of the leaders with which they can manage directly economic performance.

Connection between institutions and leaders

Studies, emphasising the importance of institutions, take centre stage in the explanation of economic growth.

Institutional economists, such as Acemoglu–Johnson–Robinson (*2002*) and Olson (*1996*) are of the opinion that institutions are the real source of growth. This simply means that solely the good institutions (democracy) represent growth. Mijiyawa (*2013*) shares this view but adds that the property rights institutions are what really matter. However, it is important to see, if we accept the concept of institutional economics, that there is at least one question that remains open. How do institutions evolve or may they be tranformed? Acemoglu–Johnson–Robinson *(2002)* show that there is a strong relationship between institutions and leadership. They take a view called social conflict theory according to which economic institutions (*property rights, institution responsible for macropolicy, regulatory institutions*) are not formed by society as a whole but by (a) group(s) with political power in their hands. For this reason it is not effectiveness that needs to be considered first and most importantly during the process of the formation of institutions, rather, it is those structures which protect the interests of political elites.

Political leaders matter? Individual vs. group

To understand how political leaders can modify the direction of economic growth in this section I will point out to the importance of political leaders and the leadership group then I will illustrate how they can be connected to institutions. The main conclusion of this section is that institutions affect political leaders and even more so the economic policy designed by political leaders which determines economic growth.

Several theories deal with the question of how a leader's personality can manage economic growth. The Great Man theory is accepted by a number of historians. Caryle (*1837*) claims that the world has been formed by the great man's decisions. Keegan (*1998*) has also the same point of view about the significance of Great Man, highlighting the role of Lenin, Stalin, Hitler, Mao, Roosevelt and Churchill. Gergen (2005) illustrates that the ability of leaders attributed to a brighter economic performance in the USA. Despite the above mentioned studies, many researchers reject the significant role of political leaders. Tolstoy (*1869*) states that the leaders like a puppet gave their name to famous events, without having any say in history. Spencer (*1873*) underpins Tolstoy's opinion. He says that society evolved in a gradual, natural and progressive way without taking actions by individuals. Nevertheless naysayer's opinions can be backed up by the evolution of institutions (*David 1994*) including how institutions derived from similar sturctures built up in the past to achieve a given aim.

The role of the leader or the leadership group are also emphasized by the selectorate theory of Mesquita et al. (*1999*). In this theory, the size of the selectorate and the winning coalition are the key to understanding the process. As Mesquita et al. (*1999*:*148*) write, „a subset of the citizenry has an institutionally legitimate right to participate in choosing the country's political leadership. This subset is a selectorate. The selectorate can be very small, very large or anywhere in between". The members of the selectorate who can maintain any incumbent leaders position in office we call a winning coalition. The selectorate theory connects institutions, leaders and economic performance in one unit. Mesquita et al. (*1999*) investigate how political institutions affect the ability of leaders, in order to maintain their power.

Political institutions represent limits and stimulus at the same time: in addition they help to make credible commitments and, as a result, they diminish the forces for economic and political agents to be opportunistic. (*Pereira 2011*). Both selectorate and winning coalition are regarded as political institutions that influence the decisions of the leaders or/and his or her survival in office. The relation between political institutions and the survival of the leaders is reflected in the work of Mesquita et al. (*1999*) in a way that the authors state that the most fundamental thought is that leaders are interested at first in grabbing and maintaining power. A policy failure however, does not necessarily lead to a leader change, since the change of the leader rests on the characteristic of political regime, too. In brief, institutions have an influence on leaders which impacts indirectly the economic policy formed by the political leader. In this case, the characteristic of a political regime, which is crucial, is the size of the selectorate and the winning coalition.

The relationship between political success and political institutions is reflected by the fact that the bigger the winning coalition, the smaller the scale of private goods with which political loyalty is purchased. As the winning coalition gets larger, it becomes harder to buy loyalty with only private goods. Supporters of the leader may lose private goods provided by leaders if the actual leader is defeated by his rival. Leaders benefit from a political system with a large selectorate and a small winning coalition. A small coalition increases loyalty towards leaders and a bigger selectorate help leaders to be more likely to survive and to decrease the chance that the defector will be in the rival's winning coalition.

Accordingly, differences in the survival probability of political leaders actually reflect the differences of political institutions. If the leaders manage a system with good political institutions regardless of whether they pursue a good policy or not, they will obtain some assurance against being replaced by their rivals. Institutional settings can provide an answer to the question as to whether leader survival correlates with economic performance. Longevity in office can be prolonged by good political institutions even if the leader's policies fail.

A large winning coalition puts pressure on leaders concerning public policy, which makes leaders grow interested in the welfare of society. Otherwise, in a political system with a small winning coalition and a large selectorate, it is far easier to compensate constituents with private goods, so the leaders are less committed to the general welfare of the society. As opposed to Tolstoy, leaders are not simply acting like puppets. Their abilities–, and personalities are indispensable for maintaining colaition –there is mutual feedback between leaders and the coalition.

A large winning coalition with a large selectorate is especially the feature of democracy. This type of system does not support loyalty to the leader, and this is the reason why – as opposed to autocracy – democracy induces disloyalty by backers when faced with policy failure. As a result of disloyalty, (losing office) applying better economic policy will become a personal interest of political leaders, since bad performance decreases the chance of being in office any longer. Since disloyalty entails the ouster of the leader in a democracy, the combination of a large winning coalition and a large selectorate is not beneficial for leaders. Political leaders want to stay in office for a long time which requires loyalty from their backers. Since an autocratic regime provides supporters with the required loyalty, this is the only system that is beneficial for leaders.

The study of Mesquita et al. (*1999*) corresponds with the research by Acemoglu–Johnson–Robinson *(2005*). Institutional economists say that the interaction between economic and political institutions is based on the fact that economic institutitons basically determine economic performance, but in the forming/replanning of economic institutions political institutions and people with political power play significant roles. As a result, political institutions, through leaders, have an effect on economic performance. Wintrobe (*1998*) and Geddes et al. (*2014*) make an argument similar to that of Mesquita et al. (*1999*), highlighting the importance of the leadership group. Both studies investigate how significant the role of the leader and the leadership group are in the formation of a regime. Wintrobe (*1998*) claims that a leader is not omnipotent, requiring others to carry out his orders. A leader is never confident about the size of his backers. This is the dictator dilemma,– which can be solved in two ways: by suppression or by loyalty. To survive, a leader has to strike a balance between these two options. Wintrobe analyses the dictator's trade-off between punishment and other means of obtaining loyalty of the population in order to hold onto power. The combination of the two option will define the regime's characteristic (military, one party, personal).

Geddes et al. (*2014*) also find the supporters of the leaders so important that the leadership group itself is put in the centre of their model and is considered as the most determinant factor of an autocracy regime. Leadership group here resembles the definition of selectorate used by Mesquita et al. (*1999*). An important difference is that it is not only the size of the leadership group that matters, it is its interest, too that does. To retain its power, a leader needs to obtain the support of members of the group and has to have those capabilities with which he or she can sway the members of the leadership group. Consequently, the significance of the leadership group is rather similar to what Mesquita et al. (*1999*) call winning coalition.
Geddes et al. (*2014*) argue that the basic substantive traits of the group, such as a hierarchical relationship, that affect autocratic decision-making make it possible to distinguish between different regime types. The reason why the authors separate various regime types is their hypothesis that the decision-making norms and power distribution within the leadership group have a strong effect on what will happen after members of the group seize power. Based on this separation they can distinguish military, party-based, monarchic, personalistic oligarchic or hybrid dictatorship. The classification refers to whose hands the control over policy and security apparatus are in (one party, royal family, narrower group). These regimes may have the same formal institutions which do not determine the membership in the group, however, the role of informal institutions is found indispensable in regime formation. In contrast Mesquita et al. (*1999*) define regime by the size of the selectorate and the winning coalition, regardless of substantive differences and the concrete political institutions that embed individuals. According to Geddes et al. (*2014*), a regime is defined as a set of basic formal and informal rules for choosing leaders and policies. They consider the informal rules as the most central factors in distinguishing autocracies by identifying the

group from which leaders can be chosen and by determining who influences leadership choice and policy.

Leadership groups have special interests with which elites in different regimes have an influence on decision-making, domestic and international policy as well. As the leadership group is the one that makes important decisions about key policies, it is necessary for a political leader to gain the support of the members of the group if he wants to stay in office.

The effect of leadership group on economic performance is also explained by regime uncertainty, a notion developed by Higgs (*1997*) to explain why the Great Depression of 1929-1933 was prolonged. Roosevelt's policy or New Deal Programme – which boosted government interventions and money-printing, caused recovery to delay. The ideology of the government is the key of evolving regime uncertainty by making private property rights doubtful. The government's incredible commitments led investors to be uncertain about the regime and to refrain from investment. According to Kroos (*1970*) „Business leaders sincerely believed that the government was an evil hands…and preparing the way for socialism, communism, or some other variety of anti-Americanism". Accordingly, the security of private property rights hinges not upon the letter of the law, but also on the character of the government that enforces or threaten presumptive rights (*Higgs 1997: 568*). The uncertainty of Roosevelt's economic policy, Higgs (1997) argues, was sustained by his interventionist's ideology, and finally resulted in a slow recovery with 10 million people remaining unemployed and –17% of the unemployment rate at the end of the decade.

Political leaders' role in the forming of institutions

Earlier, I reviewed the literature which focuses mainly on leadership groups. In this section, I will review some of those papers in which the leader itself plays a central role. I will emphasis that the leader is capable of forming institutions directly, not indirectly as the earlier studies suggest, which allows the leader to regulate economy.

Acemoglu–Johnson–Robinson's (*2002*) assumption of political elites – mentioned earlier as a social conflict theory – is behind the work of Kamrava *(2010)* in which he investigates the relationship between state leaders and state institutions mentioning that there is a little attention paid to the dictators' manipulation of institutions as a way to deepen and solidify their hold on power.

The fundamental point of his study is that the dictators may inherit or create institutions, but later on they fight against the institutions' independence. When these institutions obtain too much independence or demonstrate that they might become platforms for political opposition, then they are simply closed or dispersed by leaders. In addition as Kamrava (2010) shows, state leaders often create specific institutions designed to enhance their powers and their political longevity.

A proliferation of new state institutions often takes place during periods of political institutionalization. The new state leaders of a state want to modify or create institutions in a way that is compatible with their vision, needs and capabilities. Although state institutions constrain the leader's free will, in non-democracies, they are easily to altered or maintained by the leader's wishes and visions. Put differently state leaders are able to keep a tight rein, treating institutions as appendages which are meant to enhance their power.

Using three case studies, Iran, Kuwait, and Egypt Kamrava (2010)- shows that at any stage of a state's formation both leaders' decisions and endogenous development within institutions are responsible for the change of state institutions. This means that a dictator's rational choice, combined with path dependence, determine the direction of the change of institutions.

As long as state institutions do their jobs – keeping leaders in office – they remain intact creating path dependence. However if they exhibit any sign of being somewhat independent leaders intervene in order to hold their power.

Papaioannou – van Zanden (*2012*) also contribute to the literature on the links between economic growth and political leaders. Logically, what the authors investigate can be connected to the leaders' manipulation of institutions by Kamrava (*2010*). The authors examine what the connection is between the leaders' tenure and economic performance through the „dictator effect". Their study examines the role or/and change of institutions resting on years in office. The main question of their paper is whether the ruler with a long tenure has any influence on the quality of institutions. To test the hypothesis a linear regression model is introduced, where the quality of an institution is the independent variable. Results indicate that the institutions are negatively affected by a long tenure, which is the most significant in a monarchic and military regimes. In short spending more years in office harms the quality of institutions, but the real effect depends also on the regime types.

New approaches to examining political leaders

The significance of the leader's role, as the papers reviewed above display, can be studied in many ways, but the available databases are not always enough to shed light on the effect of a leaders

Geddes et al. (*2014*) lay an empirical groundwork for better analysis by establishing a new dataset. Their work makes it possible for us to get a deeper understanding of the nature of the relationship that can be found between leader change and regime change. In addition, the authors try to better explain what circumstances are needed for a dictator's ouster to lead to democracy instead of a new autocracy. Their key point is that when the leader of an autocratic regime loses power, one of three possible outcomes happens.

In the first case, the regime persists, since the leader is replaced by someone from the incumbent leadership group. The second possible outcome is the one in which the incumbent leadership group is replaced by democratically elected leaders. The third possibility occurs if the incumbent leadership group loses control over the other groups, one of which replaces the old regime with a new autocracy. Transition from autocracy to autocracy rises an important issue: the relationship between economic growth and the autocrat's survival. Several studies tend to regard the autocratic breakdown as being synonymous with the rise of democracy, which underestimates autocratic vulnerability to economic crises.

The new dataset by Geddes et al. (*2014*) identifies 280 autocratic regimes during the period of 1946-2010, giving new information about the autocratic breakdown or its emergence. According to the authors, there are three ways of thinking about autocratic political survival: leader survival in office, regime duration, and continuous autocratic spell. The use of autocratic leadership tenure underestimates the survival of autocratic regimes, because regimes often survive after the ouster of individual leaders – a fact that is not taken into account in most empirical studies.

Leader change is when a leader's successor is chosen from the same inner circle as the ousted leaders, if not only the leader but also the leadership group changes, then this is called regime change, because rules determining the leadership group change as well. A test conducted by Geddes et al (2014) shows that leadership failure rates are higher than the regime failure rates. The difference between the two rates depend largely on the characteristics of the regime –in military dictatorships leader failures rate are the highest. The results reveal that using only leaders survival is not enough to test entire regimes, since it would underestimates autocratic durability.

The history of Iran illustrates what the difference is between regime change and leader change. Since 1925, two successive regimes have governed Iran. Despite the continuity of autocratic governance, the two autocratic regimes bear no similarity at all, demanding pretty

different policy responses. Accordingly regime change occurred since the two leaders were from of different inner circles, yet the regime change has not interrupted the continuous autocratic spell.
Additionally, Geddes et al. (2014) draw a line between autocratic regimes and autocratic spells. An autocratic spell refers to the consecutive calendar years a country is ruled by some form of dictatorship. In short it is the length of time that tells if a country is not democratic. Spells only end when democracy interrupts them. These distinction help compliment the Polity Durable[2] variables. The problem of Polity score is that does not allow for autocracy to autocray transitions because regime ends are only identified when the country democratizes. The probability of democratization is more likely in military dictatorships, where the leaders are more willing to make deals during transition. Personalist dictatorships are least likely to democratize, and the dominant party regimes are more likely to become autocracies again after a transition.

Conclusion

The central point of the article is whether the leader itself or the leadership group matter in economic performance. I argued that to have a real understanding of this proposition, we must incorporate some notions of institutional economics into our analysis. This is because institutions are the medium between society and the group of those in power. On the one hand, institutions have an effect on the leader's decisions, indirectly influencing economic performance –, on the other hand, a great deal of the literature has been dealing with the opposite effect as well. This means that the leaders are capable of manipulating institutions, as long as these are compatible with their visions or desires which results in a step change not only in the

[2] Polity Durable by Marshall–Jaggers–Gurr (*2010:17*) is the number of years since the most recent regime change (defined by a three-point change in the Polity score over a period of three years or less) or the end of transition period

institutions but also in the economic performance either. The „dictator effect" also has an importance to apprehend what sort of role the political leaders have in the economic growth.

Recently, new and more intricate databases have emerged which show the growing importance of a leader's personality. These breakthrough developments may make the testing of empirical theories far easier, throwing new light on the role of political leaders.

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