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Middle Class Political Competition and Economic Growth

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MIDDLE CLASS,
POLTICAL COMPETITION
AND
ECONOMIC GROWTH

By

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ABSTRACT

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Middle class individuals play a fundamental role in countries' political and economic spheres. Their political demands for a fair tax system and public goods provisions enhance positive economic performance and development. A large share of income held by the middle class, according to Easterly (2001), is positively related to economic growth and political stability. Similarly, Alesina and Rodrik (1994) –among other political economic studies- highlight that a well-endowed median voter population influences the implementation of growth-enhancing economic policies.

This study examines the interplay between political competition and a politically active middle-class and its subsequent effect on economic growth. The dependant variables are real GDP per capita growth rate and GDP per capita in its logarithmic form. Middle class is defined as the median voter population represented by the third and fourth quintiles in income distribution. Political Competition is defined under the variable "Political Competitiveness" of the Polity IV Project.

Cross-sectional regression analyses are carried in the periods 1980-1994 and 1995-2009. This study's empirical results find a dichotomous effect of political competition on middle class' economic performance. On the one hand, a politically active middle class positively influences economic growth. On the other hand, political competition's suppression is positively related to economic growth. Analysis and comparisons of case studies in Latin America and East Asia shed additional light on regression results and provide grounds for the design of potential economic policies.

ACKNOWLEDGEMENTS

This study is dedicated to diligent white and blue-collar workers in our planet who, despite the challenging adversities in a highly conflicting and globalized political economic world, persevere in the labor market in order to provide food, shelter and, above all, love in their households.

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CHAPTER ONE

INTRODUCTION

"Thus it is manifest that the best political community is formed by citizens of the middle class, and that those states are likely to be well-administered, in which the middle class is large… where the middle class is large, there are least likely to be fractions and dissension"

Aristotle 306 BC

William Easterly, in his 2001 publication "The Middle Class Consensus and Economic Development", uses the aforesaid statement as a motivating quote for the reader. Aristotle's observation, made about two thousand years ago, intuitively analyzed the important role of a robust and large middle class for economic growth which consequently contributes to *political stability*. It is important to note, however, the following contextual factors. First, Aristotle lived during the golden years of the Greek Empire and he, himself, belonged to this socio-political and economic class. Secondly, Aristotle found himself living in Greece's magnificence right before Alexander's successful campaigns to the east. Thirdly, Aristotle's notion of a "large middle class" might imply that such a phenomenon occurred throughout the empire. Nevertheless, as he points out accurately, the conception of a middle-class was also connected to "citizenship status," an attribute tied to education, status and income which not every Greek was capable to benefit from.

Similar to Aristotle, Easterly defines a *middle-class consensus* as a "high share of income for the middle class and a low degree of ethnic divisions." He argues that such a "situation of relative equality and ethnic homogeneity" leads to higher income and higher growth with positive spillovers to education, public goods and political stability. In his assessment and observation of the middle class consensus, Easterly bases his paper on

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two strands of literature. The first one is the economic literature on resource endowments and income inequality and redistribution. The second strand of literature derives from the links between ethnic divisions and conflict to poor growth outcomes and the poor provision of public goods.

In the first strand, Easterly admits that he is directly inspired by Engerman's and Sokoloff's 1997 and 2000 publications. These scholars link the acquisition of natural resources in the tropics by elites, especially in Latin America, to high inequality and to both low human capital and development. In addition, Easterly bases his argument on authors such as Alesina and Rodrik (1994), Persson and Tabellini (1994), Deininger and Squire (1998) who link high levels of inequality to poor growth outcomes, thus supporting Engerman and Sokoloff's findings.

Easterly ingeniously intertwines ethnic conflict and income inequality with politics by constructing the concept of a "ruling ethnic elite" which is reluctant to invest in education and public goods. In addition, various economists' findings on the relationship between ethnic diversity and economic growth serve as supporting arguments for the middle class consensus' construction and development. Nevertheless, the effect of politics within middle class' economic functionality is left uncovered.

A. *The contribution and organization of this paper*

This study examines the interplay between political competition and a politically active middle class and its subsequent effect on economic growth. The dependant variables are real GDP per capita growth rate and GDP per capita in its logarithmic form. Middle class is defined as the median voter population represented by the third and fourth

quintiles in income distribution. Political Competition is defined under the variable "Political Competitiveness" of the Polity IV Project.

Cross-sectional regression analyses are carried in the periods 1980-1994 and 1995-2009. This study's empirical results find a dichotomous effect of political competition on the influence that middle classes have on countries' economic growth. On the one hand, a politically active middle class positively influences economic growth. On the other hand, political competition's suppression is positively related to economic growth. Analysis and comparisons of case studies in Latin America and East Asia shed additional light on regression results and provide grounds for the design of potential economic policies.

The organization of this paper is as follows. Chapter Two provides a review of the existing literature regarding human capital accumulation, income distribution, political competition and the role of middle class on economic growth. Chapter Three describes the econometrics models used in this analysis together with their theoretical rationale. Chapter Four illustrates the empirical results obtained from econometric analysis. Chapter Five presents the exploration of case studies in Latin America, East Asia and a brief discussion on the Middle East. Chapter Six provides conclusions.

CHAPTER TWO

LITERATURE REVIEW

In this chapter Easterly's (2001) relatively short literature review will be expanded. First, the literature on natural resources and endowments will be covered. Then, publications on income inequality and growth will be discussed. Subsequently, the role of political stability and competition on growth will be described. Then, the importance of the middle class on both political and economic spheres will be portrayed. Finally, a brief summary is displayed.

A) *Human Capital Evolution: Investment and underinvestment*

Sokoloff and Engerman (2000) study the New World economies' high levels of product per capita during their colonization in contrast to low levels of production and high income inequality after their independence. Conversely, former colonies such as Canada and the United States, more specifically, were able to sustain high economic growth in the late eighteen century. These scholars argue that factor endowments and their acquisition defined human capital evolution and income inequality, depending on the nature of natural resources. For example, sugar plantation operations, although very profitable, benefited a rich minority which owned large portions of land. The vast majority, constituted by a large pool of slaves, experienced little –if any- human capital development (e.g. Brazil, Jamaica and Barbados). Similarly, Spanish American colonies' richly endowed with mineral reserves were administered by a privileged few. The income distribution in these future countries' societies was, consequently, highly unequal (e.g. Bolivia, Peru and Mexico).

In contrast, the United States and Canada were endowed with neither a substantial population of natives nor climates and soils that bestowed a comparative advantage on large-scale crop production. Instead, development was triggered by highly homogenous individuals of European descent with similar levels of human capital. Thus, distribution of wealth was relatively egalitarian which allowed investment in human capital. Similarly, Acemoglu, Johnson and Robinson (2001) developed an argument that supports Sokoloff's and Engerman's assertion. European mortality rates were used as an instrument under the assumption that high mortality rates in a specific region will lead to "Extractive States" (Haiti, Cuba) whereas "Neo-Europe states" will emerge where mortality rates were low (United States and Canada). Their findings confirm such a statement. In addition, Hodler (2005) argues that natural resources lead to rivalry, especially, within ethnically diverse nations. Differentiated and conflictive goals between ethnic groups create distress which hampers productivity. Lower productivity, consequently, incurs poorer human capital development.

Social conflict and rivalry could, eventually, erupt into a revolution. Acemoglu and Robinson (2000) argue that the Western European elites were forced to extend voting rights (the franchise) to certain groups in societies, besides redistributing income, under upcoming revolutionary threats. These groups were successful skilled workers – merchants, scientists and laborers- who economically emerged after the Enlightenment and the Industrial Revolutions. As a result, most Western European nations reached the top of the Kuznet's curves of inequality and economic growth in the late nineteenth century. The investment on human capital allowed this positive transition to take place.

Likewise, Bourguingon and Verdier (2000) constructed a dynamic simple model in which the elite has the incentive to boost economic growth by increasing human capital through education. This, however, came at a cost. Assuming that political participation increases with education, the elite's political power diminished with the rise of an economically and politically influential middle-class. Western European nations and Neo-Europe states (the United States and Canada) are examples of such a developmental path. Furthermore, they argue that some countries are trapped in low-income, slow-growth and authoritarian regimes that do not allow this transition to occur. African, Latin American and some Asian nations are shown as examples.

Certainly, most of the New World's nations experienced a peculiar path of human capital accumulation during colonization. For instance, the Spanish Crown founded universities across its colonies in order to satisfy the wealthy gentry of European descent in South America. For example, "The Royal and Pontifical Major University of Saint Francis Xavier of Chuquisaca" was founded in Sucre, Bolivia in 1624 by order of the Spanish King Philip IV and with the support of Pope Innocent XII. Law and Theology were taught in this university. An educated middle-class emerged which, through education, became politically active. The predecessors of independence were, in fact, students from these universities. The first spark of revolution and independence in the Americas occurred in 1809 in Sucre organized by the Zudáñez brothers, who were graduates from the aforesaid university. Thus, a similar path towards democracy occurred, though under marked historical and ethnic differences. Unlike the Western European middle-class, the educated middle-classes in most of the New World were a marginal minority. The collapse of Spain's hegemony in the Americas occurred partly

due to an ongoing political and economic instability in the other side of the Atlantic. In addition, *mestizaje* and discrimination became ultimately intertwined with middle-class status which was not solely based on educational attainment or income. Finally, the educated middle-classes, once in power, denied further human capital development and persisted with enslaving the indigenous, poor masses.

The perpetuation of low human capital investment and poor growth outcomes is studied by Easterly (2007.) He intuitively observed that human capital accumulation partly derives from the relative suitability of land for sugar and wheat crops. If land is suitable for the former crop, large scale production and *slavery* are required for such an endeavor. Consequently, institutions that perpetuate inequality are established. In contrast, if land is suitable for wheat, low scale production and the *"family farm"* model promote human capital accumulation. As a result, institutions that promote family-farm values and egalitarianism are established. The validity of Easterly's instrument suggests that inequality does cause underdevelopment, especially at the institutional level. Thus, this scholar clearly defines two kinds of inequalities: Structural Inequality and Market Inequality. The latter is explained by the fact that there will always be losers and winners in the market. Nevertheless, Structural Inequality is far more complex as it has historical roots of colonization, ethnic fragmentation, land distribution and conquest. Easterly explains that Structural Inequality prevents human capital investment and the emergence of a middle-class. Thus, a colony's natural resource endowments partly defined the evolutionary path that human capital was going to undertake after independence.

B) Income Inequality and Economic Growth: Diverse Perspectives

Given the differentiated paths undertaken in terms of human capital accumulation, income inequality arises within a country's population which affects economic growth in various ways. The economic literature on income inequality and economic growth, however, exposes differentiated and oftentimes conflicting views. Alesina and Rodrik (1994) develop a model of endogenous growth where the conflict of income redistribution and tax policies are at stake. They argue that higher levels of inequality lead to high levels of capital taxation which, consequently, affects growth negatively. Similarly, Persson and Tabellini (1994) find a strong negative relationship between income inequality and economic growth. They develop a model in which investment is taxed as a method for income redistribution. These scholars' findings support the negative relationship between economic growth and income inequality.

Although these two publications' findings illustrate a common relationship between income disparity and growth, they differ in their outlook towards the role that political regimes play in redistribution. Alesina and Rodrik (1994) argue that democracies and non-democracies do not differ in the negative relationship between inequality and growth. They highlight the existence of pro-capital regimes –minimize redistribution and maximize growth– and populist regimes –which do the opposite– and that these could be either democratic or undemocratic. Conversely, Person and Tabellini (1994) assert that the negative correlation between growth and income inequality is only present under democratically established regimes. Alesina and Rodrik (1994,) however, provide a reasonable argument for their assertion. They state that dictators, under the threat of

being overthrown, are as likely to implement growth-retarding redistribution policies as democratically-elected presidents tend to do, so as to remain in power or to be re-elected.

Li, Squire and Zou (1998) argue that the levels of income inequality remain stable over time across countries. As evidence, these scholars highlight the constant Gini coefficient of nations –such as India's 32.6 in the last forty years. As a result, they state that income inequality varies more across countries than within countries. These scholars propose that a higher or lower income inequality depends on the rate of economic growth. Thus, reducing inequality does not necessarily guarantee an increase in economic growth as Alesina and Rodrik would otherwise suggest. Furthermore, they state that such a conditional relationship highly depends on a country's level of democratization.

Countries with similar democratic systems, however, may choose different systems of income redistribution and public goods provisions. Benabou (2000) argues that redistributive policies may have positive effects on economic growth, if they fix capital market imperfections for the poor. Nevertheless, he argues that political support for said policies is negatively related to income inequality. In any case, according to Benabou, low income redistribution leads to higher inequality in the future which constrains investment and affects economic growth negatively. Thus, he highlights the existence of multiple steady states for social contracts. Benabou categorizes two highly distinct social contracts as archetypes: the United States and Western Europe. The former engages in low redistribution and high inequality. In contrast, the latter has a strong welfare system which reduces inequality. Thus, the relationship between income inequality and economic growth depends on the country's relative social contract.

Although studies have shown explicit results which display a linear relationship between income inequality and economic growth, Banerjee and Duflo (2000) argue that linear-cross country regressions do not provide definite results. In their simple political economic model, an economy is constituted of two competing political classes: class A and class B. On the one hand, consider an exogenous factor that *raises* income inequality –say a rise in oil prices. Assume that class B is an oil seller and A is an oil buyer. Clearly, B is better off and A worse off. As a result, these two conflicting classes clash and, other things being equal, a decline in economic growth occurs. On the other hand, consider an exogenous factor that *decreases* inequality –say higher income redistribution. Assume that higher taxes are imposed to class B in order to provide cash-transfers to class A. As a result, class B fervidly opposes before this transfer is finally implemented, causing social turmoil and loss of efficiency in the process of bargaining. Thus, *ceteris paribus*, the economic growth rate declines due to net loss of productivity in the bargaining process. Therefore, whether income inequality increases or decreases, the economic growth rate falls due to an ongoing political battle to counteract inequality. In addition, these scholars state that "countries, like individuals, are different from each other." Thus, a clear-cut relationship between income inequality and growth cannot be predicted.

C) Political Stability, Competition and Growth

A vast literature exists on the importance of political stability and growth. Mauro (1995) uses ethnic diversity as an instrument in order to find a correlation between corruption and growth. He finds that corruption and political instability may be intrinsically linked. As a result, his findings suggest that there is a negative relationship

between ethnic diversity and political stability. Consequently, political instability is associated with poorer economic performance.

Political instability, however, may be controlled by the government. Annett (2001) argues that higher government consumption may ease political instability. Nevertheless, this outcome leads to an under provision of public goods which, consequently, hampers economic growth. Furthermore, Annett states that such a mechanism might be used by politicians to gain popularity in order to diminish the risk of losing office.

Internal conflict, caused by ethnic heterogeneity or income inequality among other factors, is not the only threat to political stability. Rodrik (1999) explored the effect of negative external shocks on countries' economic growth rates, in the 1960-1975 timeline, by studying the efficiency of domestic conflict-management institutions. He developed a simple model of a "shrinking pie" (the economy), after an external shock, in which opportunist groups attempt to take a bigger slice of an already smaller pie. Political stability and efficient domestic conflict-management institutions were shown to play a key role as safety-nets for the economy that allowed a faster macroeconomic transition towards recovery and higher growth.

Income inequality inevitably causes social polarization across the population. This phenomenon is analyzed by Keefer and Knack (2002). According to them, the government might be committed to redistribute income in order to ease polarization. They assume that social polarization is reflected into political polarization. As a result, a highly polarized society would have multiple political preferences. The government could be forced to implement extreme redistributive policies to satisfy multiple demands in order to control polarization. As property rights become utterly marginalized from the

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political agenda, the growth rate might inevitably fall. Nevertheless, these scholars highlight that some redistributive policies, such as those targeted to improve property rights, could have positive effects on economic growth.

Political polarization, however, might not necessarily be counterproductive to economic growth. Chaudhry and Garner (2006) argue that political polarization ultimately leads to political competition across countries. They cite Landes (1998) and Diamond (1997), two economic historians who state that Europe's historical political fragmentation promoted modern innovation and higher economic growth. In contrast, China's early political unification blocked innovation throughout its history. These scholars develop a simple model of conflict between two countries in order to study the effect of political competition on growth. Their results suggest that political competition between countries is an important growth enhancing mechanism. In addition, they conclude stating that such positive mechanism to economic growth could be applicable within countries' political spheres.

Bardhan and Yang (2004) develop a model in which the costs and benefits of political competition are analyzed. In particular, they study the role of political competition on the realization of politically feasible public investments. They find that electoral politics can thwart long-run investments even when these are approved by a majority. Politicians do so when short-term spending programs are able to satisfy the public. These scholars highlight that information asymmetry and distributional conflicts affect political competitions' outcome onto economic growth. Therefore, political competition's effect on economic growth highly depends on country-fixed factors such as historical competition, income inequality and appropriate diffusion of information.

D) The Middle-Class in the politico-economic sphere

As discussed above, Alesina and Rodrik (1994) stated that high levels of taxation rate, due to high levels of inequality, lead to a fall in economic growth. These scholars highlight the importance of the median voter to justify this mechanism. They suggest that the better endowed the median voter is with income and capital, the lower the taxation rate that will be implemented. Similarly, Benabou (2000, p. 108) states that "the decisive political group is located above the median in terms of income and human wealth." Thus, the middle-class plays a fundamental and influential role in both a country's social contract and implementation of redistributive policies.

The importance of the middle class both as a mediator between the poor and the rich and its role in a socio-economic spectrum was studied by Josten (2005). This scholar, based on a game-theory model, analyzes the effects of social capital built within the middle-classes' networks of trust and mutual cooperation on the economy. He finds that the development of social capital enhances individuals' agreements on the provision of public goods and considerably reduces the transaction costs inflicted by imperfect capital markets. In addition, social capital discourages opportunistic political behavior which, as a result, leads to a lower demand for redistributive policies and higher economic growth. Josten warns, however, that when the size of the middle class shrinks, social capital is depleted and opportunistic behavior ultimately arises. Thus, middle class' networks of trust and cooperation may guarantee the development of a growth-enhancing political competition.

Conversely, Li, Squire and Zou (1998) study the behavior of the richest households in society. In their model, society is split in two segments: a richest minority and a poor majority (which includes middle-class individuals and the poor). They argue that the rich minority is able to control the economic system through its economic power or political control. Nevertheless, their power and control is limited by the level of society's democratization, liberty and education. Thus, the level of influence of the middle class highly depends on its active position and role in the political economy.

The processes of democratization and middle-class emergence, however, have crucial historical components. Acemoglu, Johnson, Robinson and Yared (2008) investigated the positive relationship between income and democracy. Their findings suggest that this relationship disappears when country-fixed effects, such as colonization, are put into consideration. These scholars compare the development of the United States against Bolivia. The former developed under a relatively egalitarian social structure which allowed for the emergence of a sizeable middle-class. In contrast, Bolivia developed under a repressive socio-economic and political structure which hindered middle-class emergence severely. Industries and entrepreneurs could flourish in the United States whereas in the Andean nation, oligarchs hampered industrialization and growth. As a result, these economists propose the existence of "divergent political-economic development paths" and suggest "thinking of *political and economic development* taking place *jointly*" (p. 829).

In a similar framework, Persson and Tabellini (2006) study the relationship between political regimes and economic growth. They find that countries under presidential and majoritarian democracies grow faster than parliamentary and proportional regimes. This

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finding confirms the importance of the median voter population on economic growth. In addition, these scholars suggest that the probability of regime change −from a democracy to a coup- highly depends on the accumulation of "democratic capital." Although democratic capital is not specifically defined in their study, intuitively, it can be contrasted to the emergence of a substantial middle class. Furthermore, Persson and Tabellini (2006) find that the probability of a regime change lowers economic growth. Thus, a sizeable middle class provides political and economic stability as it may prevent drastic regime changes.

Summary

Factor endowments, colonization, major advances in technology and social revolutions have, indeed, shaped −one way or another− the initial development and evolution of human capital across countries. On the one hand, European colonizers and 'Neo-Europes' experienced the emergence of a substantial middle class. On the other hand, the vast majority of colonies in the New World faced severe impediments to build a stable, functional and sizeable middle class. As a result, countries in the world have embarked in different developmental paths.

Although meaningful consensus exists on this assertion, the relationship between income inequality and economic growth remains unsettled in the economic literature. Many firmly advocate that income inequality is negatively related to growth. Others, in contrast, suggest that the Kuznets' curves of income inequality provide a most plausible rationalization. Similarly, disagreement prevails in the fairly recent economic literature on political competition.

Economists commonly agree on the vital role of the middle classes on countries' economic growth. Nevertheless, scholars tend to disagree on the level of influence that individuals in this socio-economic class play in the economy. Some state that middle classes have an active stand in both democracies and non-democracies. Conversely, others argue that high levels of income inequality and undemocratic states restrict middle-income individuals' economic performance.

Given these contested and contradictory views, the present study will explore the effects of political competition on middle classes' economic performance. Most specifically, the role of a politically active middle class on countries' economic growth will be analyzed.

CHAPTER THREE

ESTIMATING THE IMPACT OF POLITICAL COMPETITION

This chapter describes the econometric models used in this analysis. The dependent and independent variables, together with a rationale for their inclusion, are described below.

A) Estimating the impact of a political middle class on economic growth: Model One

Based on the neoclassical growth model, Barro (1998) developed a model in which the phenomenon of conditional convergence was analyzed. His results support a 2% rate of conditional convergence across nations. Developing countries, with low initial levels of output, have a tendency to grow faster and to "catch up" with developed economies, however, under certain conditions such as improvements in rule of law and lower government consumption. Conversely, Quah (1995) argues that this and other findings overestimate the so-called "catching up effect". In fact, Quah's findings support a persistent immobility across countries which lead to the existence of "convergence clubs." In simpler words, Quah observes that poor countries are getting poorer, those rich ultimately get richer, and the middle class across nations vanishes. In contrast, Ravallion (2009) finds that middle classes in the developing world have been expanding considerably in the last decade. However, he warns that individuals in the developing world's new middle class are vulnerable to fall back in poverty.

Addressing this contested discussion on conditional convergence –with oftentimes contradictory findings-, the political role of middle classes on economic growth will be

analyzed. The model specification for the first model, which derives primarily from Barro (1998), is displayed below.

$$\textbf{GDP\%}_t = B_0 + B_1 \log GDP_t + B_2\, MC_t + B_3 PAR_t + B_4 MC*PAR + B_5\, EDU_t + B_6\, ToT_t +$$

$$B_7\, RLaw_t + B_8\, \textit{Regional Dummies} + B_9\, \textit{Export Dummies} + B_{10}\, \textit{Regime Dummies} + u$$

Where "t" denotes time and "u" represents the model's residual.

Dependent Variable for Economic Growth

GDP%: Annual percentage growth rates of GDP per capita in constant 2005 US$

Independent Variables

- logGDP (-)[1]   Natural logarithm of GDP per capita in constant 2005 US$

- MC (+)   Middle-Class Income Share (third and fourth quintiles)

- PAR (+)   Competitiveness of Political Participation

- MC*PAR (+) Interaction term between Middle Class and competitiveness of political participation.

- EDU (+)   Average years of secondary and tertiary schooling attained by a country's population aged 25 or over.

- ToT (+)   Terms of trade ratio measured relative to the base year 2000.

- RLaw (+)   Legal Structure and Security of Property Rights, measured by Freedom House

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[1] Expected signs of estimated coefficients are displayed in parentheses.

Control Variables

Regional Dummies

- EAP (+): Dummy variable for nations in East Asia and the Pacific.

- ECA (+): Dummy variable for nations in Easter Europe and Central Asia

- LAC (-): Dummy variable for countries in Latin America and the Caribbean.

- MENA (+): Dummy variable for countries in the Middle East and North Africa.

- SA (+): Dummy variable for nations in South Asia.

- SSA (-): Dummy variable for nations in Sub-Saharan Africa

Export Dummies

- MANU (+): Dummy variable for countries which major exports are manufactures.

- PRIP (-): Dummy variable for countries which major exports are primary products.

- OIL (+): Dummy variable for nations which major exports are fossil fuels, in particular, oil.

- SERV (+): Dummy variable nations which major exports are services.

Regime Dummies

- EX-USSR (-)   Dummy Variable for transitions economies that formed the former Soviet Bloc

- Trauma (-)   Dummy Variable for nations that underwent coups, wars or interregnums measured by Polity IV

- Repress (+)   Dummy Variable for nations which strictly repress political competition

The two fifteen year periods, 1980-1994 and 1995-2009, will be analyzed and compared simultaneously. All variables will be averaged according to their respective time-period. logGDP, however, will account for the initial level of GDP per capita five years prior to the time period in question (e.g. GDP per capita in 1975 will be included in the 1980-1994 specification). Both GDP per capita and growth rate of GDP per capita were obtained from ERS International Macroeconomic Data Set.

The key independent variable in this analysis is MC. Easterly's (2001) defined the middle class share across countries as that constituted by the second, third and fourth quintiles in income distribution. Although such approach is comprehensible, given that it accounts neither the most affluent nor the poorest in the economy, it falls under considerable limitations. The OECD's Latin American Outlook (2010) reported that, under Easterly's strict definition, 60% of Latin America's population would be considered in the middle sectors. Taking into consideration the high levels of inequality and poverty in this region of the world, Easterly's middle-class measurement clearly overstates the income share of the middle strata.

Josten and Truger (2003) display two crucial conditions that the median voter theorem in politico-economic models is based on: *1) Real-world income distributions are skewed to the right, so that the median income is lower than the average one. 2) Skewness in income distribution increases with rising inequality inducing a fall in the position of the median income relative to the mean* (p. 4). Considering these two statements straightforwardly, the second quintile in income distribution is out of range of the median voter population. Thus, in this study, the median voter population's income share will be measured under the third and fourth quintiles in income distribution across

countries. The data was obtained from the World Bank Development Indicators (WDI) dataset.

It is important to note the lack of time-series data for the middle-strata's income share which is a shortcoming of this study. WDI reports only one observation between 1980 and 2009 for several countries – such as Canada, Democratic Republic of Congo and Jamaica among many others. Other nations, however, have more consistent data entries which cover several years –most Latin American countries, Poland and Iran among others. Data unavailability prompts us to carry a cross-sectional analysis carried in similar fashion by Perotti (1996) and Alesina and Perotti (1996). Therefore, data permitting, the most recent observation pertinent to the time-period under analysis will be taken into account when the average is calculated for each specification.

The competitiveness of political participation, PAR, measures a crucial component for this study's analysis. This variable, measured by the Polity IV project, records the extent "to which alternative preferences for policy and leadership can be pursued in the political arena." This variable ranks the level of competition on a five number scale. Countries, in which political competition is severely repressed, represent 1. In contrast, nations where political competition is fluid and stable represent 5. A more detailed description of PAR's parameters in included in Appendix I. Political preferences of the median voter population are ultimately embodied within political competition. Therefore, the higher the level of political competition would essentially imply a more mature democratic system. Thus, the interaction term MC*PAR will estimate the effect that political competition has on economic growth given the relative size of the median voter population determined by its income share.

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Human capital, a crucial component for economic growth, is measured in EDU. Barro (1998) found a strong positive relationship between economic growth and average years of secondary and tertiary education for males aged twenty-five and over. In this study, however, both males and females will be considered, given women's increasing influential role both in the labor market and politics. The data was obtained from Barro and Lee dataset which is available online.

Trade has affected countries' economic growth rates throughout history. Nevertheless, under globalization and open-market reforms which were vigorously initiated in the 1980's, it has become a crucial determinant for growth in both developing and developed countries. ToT measures terms of trade ratio which is a relative price index that measures a country's price paid for its exports over the price that a country pays for its imports. An improvement in a nation's terms of trade is a positive outcome because the country is able to purchase more imports for any given level of output. Barro (1998) finds that an improvement in terms of trade ratio stimulates economic growth positively as long as this particular shift in terms of trade "stimulates a change in domestic employment and output" (p. 29). Thus, this variable attempts to capture shifts in terms of trade which could cause movements in real GDP.

Rule of law (RLaw), obtained from Freedom House, accounts for the legal structure and security of property rights in a nation. Functional legislative and judicial institutions guarantee and promote entrepreneurial activities, capital inflows and political stability. Sala-I-Martin (1997), among many other economists, confirms the positive relationship between rule of law and economic growth.

Three sets of control variables will be added independently to our set of independent variables. Their main purpose is to check for robustness as exogenous variables. Nevertheless, they also aim to analyze particular criteria. Regional dummy variables (EAP, ECA, LAC, MENA, SA and SSA) will capture, in particular, the variation of economic growth, middle class and political competition in terms of geographical location of a country. Export dummy variables (MANU, PRIP, OIL and SERV) will control for countries according to their major export. This classification was carried by the World Bank in 1995. This classification is particularly relevant given that the year 1995 is a medium point between the two sets of fifteen year periods under analysis.

Finally, a dummy variable for nations that formed the Soviet bloc (EX-USSR) is aimed to control the large size of the middle class in these countries, a product of communist policies. Nevertheless, Birdsall et al. (2000) argue that middle strata's absolute level of income in this region is severely declining. In addition, nations in which political competition is strictly repressed will be controlled under the dummy variable "Repress." The complete absence of political competition could be, in fact, positively related to growth as time-lagging in the implementation of policies is completely avoided. Furthermore, nations that underwent coups, interregnums or war will be controlled under a dummy variable (Trauma.)

B) Estimating the impact of a political middle class on economic growth: Model Two

Stemming from Acemoglu, Johnson and Robinson (2001) and Easterly (2007), in this model specification, the large differences in income per capita across countries will be studied. In particular, given the scope of this study, the effect of a politically active –or

inactive- middle-class on economic growth will be explored in order to explain such large differences. In synthesis, the model specification varies from the one described in A) solely on two parameters: The dependent variable is the level of per capita income in logarithm and the exclusion of initial level of log GDP per capita as an independent variable.

$$\textbf{logGDP}_t = B_0 + B_1\,MC_t + B_2 PAR_t + B_3 MC\!*\!PAR + B_4\,EDU_t + B_5\,ToT_t +$$

$$B_6\,RLaw_t + B_7\,\textit{Regional Dummies} + B_8\,\textit{Export Dummies} + B_9\,\textit{Regime} + u$$

C) Endogeneity issues: Middle Class and Economic Growth

Easterly (2001), as described earlier, suggests that a large income share for the middle class promotes economic growth. Nevertheless, an issue of endogeneity naturally arises. Higher economic growth, through the trickle-down effect, ultimately increases the income of the median voter population. Thus, a clear problem of reverse causality arises between this study's dependent variables and MC.

In order to counteract this issue, instrumental variables will be used. Easterly (2007) developed an instrument that measures countries' land suitability for the production of sugarcane or wheat. His argument suggests that sugarcane production induces poor institutions which perpetuate inequality and low economic growth. In contrast, wheat production encourages the establishment of functional institutions which promote equality and, consequently, higher economic growth.

Easterly's theory is suitable to this study because sugarcane production is historically connected to slavery, low human capital development and prevention of the emergence of a functional and sizeable middle-class. Conversely, wheat production is based on a lower

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scale production, based on "the family farm" which promotes equality, induces higher human capital development and encourages the emergence of a sizeable and functional middle-class. Therefore, Easterly's wheat-sugar-suitability ratio will be used as an instrument for MC in our first model.

Acemoglu, Johnson, Robinson and Yared (2008) dispute studies which find a strong cross-country positive relationship between democracy and income. They suggest that, when country-fixed effects are controlled, no causal effect can be observed between income and democracy. Nevertheless, these scholars argue that a cross-country correlation exists over the past 500 years. They use the size and density of indigenous populations in former-European colonies in 1500. Their findings suggest that high levels of indigenous population are negatively related to democratization which induces, consequently, to lower economic growth.

The density of indigenous populations in 1500 can be used as suitable instrument for the present study. High levels of population density in former European colonies translate into a vast, free labor force in the colonizers' minds. Ultimately, human capital does not develop within slavery and oppression. Thus, a sizeable middle-class is unable to emerge and democratization satisfies a small oligarchy's political preferences after independence. This instrument will control the variable of middle class in model two.

Finally, given that instruments are being used in both models, Two Stage Least Squares (TSLS) will be the econometric method utilized in this study.

CHAPTER FOUR

ESTIMATION RESULTS: QUANTIFYING THE EFFECT OF A POLITICALLY ACTIVE MIDDLE CLASS ON ECONOMIC GROWTH

This chapter presents the results of the regressions analyses described in the previous chapter. Firstly, the descriptive statistics of this study's variables will be analyzed briefly. The first subsection outlines the results of model one for two time periods, 1980-1994 and 1995-2009, utilizing the variable middle class defined as the income share by the third and fourth quintiles in income distribution. The second subsection illustrates the results obtained for model two. Lastly, the third subsection summarizes and contrasts the findings from both models.

a) *Descriptive Statistics*

Descriptive statistics of all level variables are presented in Tables A and B for the time periods 1980-1994, and 1995-2009 respectively. In the first row of Table A, the maximum level of GDP%, 8.56, represents the economic growth achieved by China. In contrast, the minimum of -13.98 represents the poor economic performance of Liberia. In the beginning of the 1980's, China's economic policies towards capitalism and trade openness triggered an outstanding economic revival. In contrast, the poorest countries of the world – such as the Sub-Saharan nation of Liberia- showed highly disappointing economic outcomes as they were unable to benefit from economic reforms set by the Washington Consensus. It is important to note, however, the low mean of 0.21. In a global perspective, this result suggests that economic growth in this fifteen year period was significantly inferior in comparison to the 1995-2009 timeline which reports a mean

of 2.54. The information revolution and a highly interconnected world economy after the fall of the Soviet Union in 1991 are both plausible explanations for these remarkable differences between these two fifteen year periods.

The high inequality of educational attainment improvements across the world may be observed when both the maximum and minimum levels are compared in Tables A and B. The prosperous nations of the United States and Germany represent the maximum levels of education for 1980-1994 and 1995-2009, (6.36 and 7.65 average years) respectively. It is important highlighting the increment of a year in education within the most educated societies of the world. At the other end of the spectrum, Mozambique – which represents the minimum for both time periods-, witnessed an increment of 0.06 years in educational attainment. From a global perspective, the improvements of average years of educational attainment show to be disappointing. Furthermore, the mean between these two fifteen time periods attained a mere increment of 0.82 years of educational attainment. Despite the economic prosperity achieved by higher trade in goods, services and capital, education seems to lack convincing development.

Political competition, in contrast, shows visible advances. A median of 2.00 in Table A indicates that the competitiveness of political participation in the world was highly suppressed between 1980 and 1994. Nevertheless, the following fifteen year period records a median of 3.63 which suggests that political competition, from a global standpoint, is closer to achieving a transition towards a highly competitive standing. This is a conceivable outcome given that a vast number of nations in the developing world, such as the Latino countries, have pursued higher levels of democratization within their polities. It should be remembered that the Washington Consensus, in one of its many

clauses, recommends –and even requires– the establishment of democracy as a pre-condition for the implementation of economic policies towards liberalization and trade-openness.

The share of income held by the middle classes in the world experienced a slight decrease between 1980-1994 and 1995-2009. The maximum in the former period is represented by Ukraine with 41.65% of national income held by the middle class. As noted by Birdsall et al. (2000), Eastern Europe's middle classes are much larger due to the heritage of former socialist economic policies. In Table B, however, the maximum of 41.51% represented by Slovakia falls 0.14 percentage points behind Ukraine's middle class. The minimum for both timelines is recorded by Namibia which middle class holds only 17% of national income. From a global perspective, the average of income held by the middle classes fell from 36.17% in 1980-1994 to 36.02% in 1995-2009. Although this decrement is minimal, when the large worldwide economic expansion in the last fifteen years is put into consideration, it is arguable the extent to which the middle classes have directly benefited from globalization.

A) Quantifying the effects of a politically active middle class: Model One

In order to counteract the issue of endogeneity between middle class and economic growth; Easterly's (2007) wheat-sugar-suitability ratio will be used as an instrumental variable to control for the key independent variable, MC, for both fifteen year periods. The rationale behind the usage of this instrument was discussed previously in Chapter Three. Therefore, Two-Stage Least Squares (TLSL) is a suitable econometric method which will be utilized for this analysis.

A1. The 1980-1994 Period

The regression results for this model specification are presented in Table 1. In the first column, the negative sign of LogGDP1975, its coefficient of 2.07 and its high level of statistical significance confirm the theory of conditional convergence found by Barro (1998.) In fact, conditional converge is proven to exist throughout this period across all specifications. Education shows the expected positive sign; however, it proves to be statistically insignificant. Similarly, terms of trade has the expected sign, yet it lacks statistical significance. Rule of law's positive sign and high level of statistical significance confirm the importance of this variable for economic growth. This study's key independent variable, *middle class*, has a positive sign which corroborates our previous theoretical analysis. Nevertheless, given that its coefficient is statistically insignificant, it is not plausible to firmly validate middle classes' positive effect on economic growth. Furthermore, a low adjusted R^2 of 0.22 suggests that the independent variables explain only 27% of the variations in economic growth rate, suggesting an issue of omitted variable bias.

In the second column, political competition is introduced as a control variable. Its positive sign confirms our expectations; nevertheless, its coefficient is statistically insignificant. The positive relationship between political competition and economic growth is displayed in Chart 1. Although middle class lacks statistical significance, an increment of 0.4 can be observed in its coefficient. This result suggests that political competition induces a slight, yet visible, increase in middle class' effect on economic growth.

In the third column, the interaction term MC*PAR is introduced in the model. Its coefficient is negative and insignificant which does not corroborate our expectations. It is interesting to observe, however, an unexpected increase in the size of the coefficients for both political competition and middle class. Middle class' coefficient increases from 0.11 to 1.81. A more noteworthy increase is observed in political competition's coefficient which increases dramatically from 0.47 to 20.10.

This abrupt change in coefficients for both middle class and political competition could be caused by multicollinearity. Indeed, when correlation matrixes are drawn into the picture, a high correlation between MC*PAR and political competition can be identified. Table C displays our variables' correlation matrix. Political competition and MC*PAR show a high correlation of 0.97. It is highly possible that this high correlation has driven the unexpected increment in coefficients' sizes, affecting the statistical significance of the aforesaid variables. Thus, in order to counteract this particular issue, these two variables will be regressed autonomously one from another.

In column 4a, regional dummies are introduced as exogenous control variables for the model. The adjusted R^2 increases substantially from 0.22 in the second column to 0.33 which suggests that the independent variables explain 33% of the variations in our dependent variable. MC*PAR is excluded from this specification. Political competition remains positive and statistically insignificant. Middle class' coefficient remains positive and insignificant. Furthermore, the regional dummy variables lack statistical significance. Nevertheless, their signs corroborate the overall economic performance of these regions. East Asia & the Pacific and South Asia show positive signs. Indeed, countries such as China, India and South Korea experienced high levels of economic growth between 1980

and 1994. Latino and Middle Eastern countries, such as Chile and Jordan, showed a significant economic revival in the beginning of the 1990's due to market reforms and liberalization of their economies. Conversely, Eastern Europe and Sub-Saharan Africa report negative signs. The collapse of the Soviet Union in 1991 caused severe recessions in Eastern Europe. Likewise, Sub-Saharan nations experienced negative economic growth levels.

In column 4b, political competition is excluded from the model and MC*PAR is introduced. Middle class remains positive and insignificant. MC*PAR is negative and lacks statistical significance. However, a strong positive relation between MC*PAR and Real GDP Growth Rate in this time period can be observed in Chart 2. Regional dummies remain insignificant. Yet, an interesting change of signs can be identified. Latin America and the Middle East become negative. The high levels of income inequality in these two regions of the world, especially in Latin America, undermine the existence of a robust middle class. Thus, one could argue, that the interaction term MC*PAR could indirectly control for the constant political instability in these countries which is negatively related to growth.

Exports dummies, which rationale is explained in Chapter Three, are introduced as exogenous control variables in columns 5a and 5b. In column 5a, middle class remains statistically insignificant but becomes negative. Birdsall et al. (2000) discuss the socio-economic vulnerability of the middle classes in the world due to globalization and market liberalization. These dummy variables could, indirectly, control for these negative effects which might explain middle class' negative sign. Nevertheless, its statistical insignificance does not allow us to draw a concrete explanation. The dummy variable

controlling for nations which major exports are primary products is negative and highly significant. This result supports the vulnerable economic reality of poor economies that depend on international prices of raw materials and foodstuffs in the global market. In column 5b, MC*PAR is introduced. Its coefficient, however, is statistically insignificant.

In column 6a and 6b, regime dummy variables are introduced. In column 6a, rule of law and logGDP1975 are highly significant, suggesting the existence of conditional convergence. Middle class remains insignificant. Yet, political competition is positive and statistically significant. Indeed, higher political competitiveness has brought positive economic spillovers. For example, the fall of inefficient dictators who suppressed political competition during the 1980's brought notable economic improvements in several Latin American countries, such as Chile.

At the other end of the spectrum, however, countries with repressive regimes report a high coefficient of 6.62 which is highly statistically significant. This result suggests that nations with the lowest scores of political competition, based on the Polity IV project, have grown substantially. China and Vietnam with growth rates of 8.81% and 5.78% respectively explain this phenomenon. Furthermore, this finding supports Persson and Tabellini (2006) who argue that countries that liberalize their economies *before* expending political rights show better economic performances. In column 6b, MC*PAR is introduced in the model but lacks statistical significance.

A2. *The 1995-2009 Period*

The regression results for this model specification are presented in Table 2. In the first column, the coefficient of logGDP1990 is -0.53 and is statistically insignificant. In

fact, throughout the specifications in this timeline, this variable lacks statistical significance. This result suggests that the conditional economic convergence found by Barro (1998) does not apply to this fifteen year period. Although statistically insignificant, it is surprising to note that education has a negative sign. The analysis of descriptive statistics in the beginning of this chapter, however, has shown that education lacks convincing progress. Thus, the resources spent on unsatisfactory educational attainment for secondary and tertiary schooling could have a high opportunity cost that, ultimately, leads to its negative effect on economic growth. Rule of Law's coefficient is positive and statistically insignificant. The key independent variable, middle class, is positive yet statistically insignificant. It is important to note, however, the negative and low adjusted R^2 of -0.01. Clearly, an issue of omitted variable bias is identified.

In the second column, political competition is introduced as a control variable. Although statistically insignificant, its negative sign does not corroborate our expectations. Middle class remains positive and statistically insignificant. A plausible explanation for the negative sign of political competition lies in the findings of Barro (1994) who argues that "democracy enhances growth at low levels of political freedom but depresses growth when a moderate level of freedom has been attained." Thus, the positive effect of political competition on economic growth observed between 1980 and 1994 could become negative in the following fifteen year period. Furthermore, the adjusted R^2 shows improvements as it becomes positive.

In column 3a, regional dummies are introduced as exogenous control variables for the model. The adjusted R^2 increases from 0.01 to 0.07 which suggests that the independent variables explain 7% of the variations in our dependent variable. MC*PAR is excluded

from this specification. All variables, except Rule of Law, lack statistical significance. Political competition remains negative whereas middle class shows a positive sign. Similarly, in column 3b, Rule of Law shows the only significant coefficient. Although statistically insignificant, the negative sign of MC*PAR does not support our expectations. This result suggests that, given the size of a middle class, higher political competition negatively affects the overall positive performance of the middle class on the economic growth rate during this time period. Barro's (1994) observations on the negative effect of higher levels of democratization in growth support this argument.

In columns 4a and 4b, export dummies are introduced as exogenous control variables. Nevertheless, for both specifications, all independent variables are proven to be insignificant. Regime dummy variables are introduced in columns 5a and 5b. The dummy for countries with traumatic democratic experiences is statistically significant and shows large negative coefficients in both specifications. This finding supports Persson and Tabellini (2006) who argue that a stable and persistent democracy matter more for economic growth than the mere establishment of democracy. Furthermore, countries with repressive regimes –as discussed in the previous fifteen year period- show high levels of economic growth between 1995 and 2009. Middle class, political competition and MC*PAR remain statistically insignificant. As a final remark, it is important to note the substantial increase in our adjusted R^2 once we control for regimes. Its value increases to 0.26 and 0.25 in columns 5a and 5b, respectively.

B) Quantifying the effects of a politically active middle class: Model Two

In this model, population density in 1500 – obtained from Acemoglu, Johnson, Robinson and Yared (2008) - will be used as an instrumental variable in order to address

the issue of endogeneity between middle class and economic growth for both fifteen year periods. The rationale behind the usage of this instrument was discussed previously in Chapter Three. The method of Two-Stage Least Squares (TLSL) will be utilized for regression analysis.

B1. The 1980-1994 Period

The regression results for this model specification are presented in Table 3. In the first column, education is statistically significant at the 99% level of confidence. It suggests that, a year increase in average year of educational attainment increases economic growth by 0.29 percentage points. Rule of Law is also highly significant and positive related to economic growth. The coefficient of middle class, however, is negative and statistically significant, against our expectations. Birdsall et al. (2000) argue that liberalization and openness have negatively affected middle classes socio-economic standing. Deindustrialization, the decline of state jobs, and under-provision of formerly universal public goods have negatively affected the positive performance of middle classes on economic growth. Thus, it is plausible that the middle classes in the world have performed both poorly and negatively in this fifteen year period for the aforesaid reasons. The adjusted R^2 of 0.49 implies that the independent variables explain 49% of the variations in our dependent variable.

In the second column, political competition is introduced as a control variable. Its positive sign supports our expectations, yet its coefficient is statistically insignificant. The positive relationship between political competition and economic growth can be observed in Chart 3. Education and rule of law remain statistically significant with their

expected signs. However, middle class loses its statistical significance. Furthermore, the explanation of the independent variables of our dependent variable's variations increases by three percentage points when the adjusted R^2 is observed.

In columns 3a and 3b, regional dummies are introduced as exogenous control variables for the model. It is important to note that Eastern Europe & Central Asia is not reported in model two. As the instrumental variable reports the population densities of former European Colonies, European nations themselves are, naturally, excluded from these observations. In column 3a, MC*PAR is excluded from this specification. Rule of law remains significant with its expected sign. Political competition remains insignificant. Middle class is negatively related to growth and statistically insignificant. All the regional dummies are insignificant which does not allow us to draw any conclusion.

In column 3b, political competition is excluded from the model and MC*PAR is introduced. MC*PAR is positive and statistically insignificant. The positive relationship between MC*PAR and economic growth is shown in Chart 4. However, middle class becomes significant at the 90% level of confidence. This result confirms middle classes' severe socio-economic vulnerability in a worldwide perspective.

In columns 4a and 4b, export dummies are introduced as exogenous control variables. In column 4a, political competition is shown to be positive and insignificant. Middle class remains negative and statistically insignificant. Exporters of both oil and manufactures show positive coefficients which are highly statistically significant. Naturally, countries that export oil benefited during this fifteen year period due to the increase of oil prices following the 1979 oil shock and the Iraqi invasion of Kuwait in

1990. In addition, those that specialized in the production of manufactures benefited from higher trade and a more integrated global economy.

In column 4b, middle class has a negative and statistically significant coefficient at the 95% level of statistical confidence. Furthermore, MC*PAR is proven to be positive and highly statistically significant. These results firmly corroborate the positive effect of political competition on middle class' economic performance which, overall, is found to be vulnerable due to its persistent negative sign. The adjusted R^2 of 0.65 suggests that the independent variables explain 65% of the dependent variable's variations. Exporters of manufactures and oil remain positive and significant.

In column 5a and 5b, regime dummy variables are introduced in the model. Nevertheless, it is important to note that transition economies and repressive regimes are excluded from these observations. Nations that formed the former Soviet Bloc are mostly European. Furthermore, nations with repressive regimes, such as China and South Korea, were not colonies of European settlers. Thus, the instrumental variable does not hold for these nations. Rule of law and education are the only significant variables in column 5a. In column 5b, both middle class and MC*PAR are significant. These results validate the positive effect of political competition on middle class' vulnerable economic performance.

B2. *The 1995-2009 Period*

The regression results for this model specification are presented in Table 4. In the first column, education, rule of law and terms of trade are significant with their expected signs. Middle class is negative and statistically insignificant. In the second column,

political competition is introduced as a control variable. Its sign is positive yet statistically insignificant.

In column 3a, regional dummies are introduced as exogenous control variables for the model. MC*PAR is excluded from this specification. Political competition is positive and insignificant. Middle class is negative and remains statistically insignificant. Terms of trade, rule of law and education are positively related to growth and prove to be statistically significant. The regional dummies are insignificant which does not permit us to draw a precise conclusion. In column 3b, MC*PAR is introduced in the model. Its coefficient is positive and insignificant. Middle class remains negative and statistically insignificant. Terms of trade, education and rule of law are all positive and statistically significant. The adjusted R^2 of 0.66 indicates that the independent variables explain 66% of the variations in our dependent variable.

In columns 4a and 4b, export dummies are included as exogenous control variables. In column 4a, political competition is positive and statistically insignificant. In contrast, middle class has a negative coefficient which is statistically significant. Exporters of primary products show a negative coefficient which is highly statistically significant. In addition, exporters of manufactures have a positive and statistical significant coefficient. These results illustrate the dichotomous benefits of international trade. Nations, which major exports are raw materials, undergo negative economic performances due to their vulnerability in the global market. In addition, these negative economic shocks inflict constant socio-economic and political destabilizations which constraint economic growth even further. In contrast, those nations that specialize in manufactures show positive levels of economic growth due to more stable prices and demand. Stability in the world

market translates, consequently, on a more persistent internal socio-economic and political stability.

In column 4b, MC*PAR is included. The interactive term MC*PAR is positive and significant. In addition, middle class remains negative and statistically significant at the 95% level of confidence. These results firmly corroborate the positive effect of higher political competition on middle classes' performance on economic growth. The dummies for manufactures and primary products exporters remain significant with their expected signs.

In columns 5a and 5b, regime dummies are introduced as controllers. Political competition, in column 6a, is positive and statistically insignificant. In column 6b, MC*PAR is positive and statistically insignificant. Middle class, in both columns, remain negative and insignificant. Similarly, the dummy for countries with traumatic democratic experiences has a negative sign but lacks statistical significance.

Summary

In model one, when we control for regimes in the 1980-1994 timeline, political competition shows to be positive and significant at the 95% level of confidence. Thus, it can be argued that higher political competition is positively related to economic growth. Nevertheless, nations where political competition is repressed show high levels of economic growth. Therefore, a finite relationship between political competition and economic growth is debatable. When regions and nature of exports are controlled, however, the coefficients for political competition, middle class and their interaction term, MC*PAR, are proven to be statistically insignificant.

The theory of conditional convergence applies to the first fifteen year period. Yet, for the 1995-2009 timeline, conditional convergence is not satisfied. A plausible explanation for this phenomenon can be provided by political competition. In our discussion of descriptive statistics, early in this chapter, we observed a substantial advance in political competition worldwide. It is possible that countries might have taken different developmental paths between 1995 and 2009 driven by higher political competition. Therefore, conditional convergence among nations could no longer be as important. It is essential to note, however, low levels of adjusted R^2 for this particular period which suggest omitted variable bias.

Model two's results offer more conclusive inferences. In the 1980-1994 timeline, middle class is negative and statistically significant at the 90% level of confidence once we control for regions. This result shows middle class' economic vulnerability which hinders its positive influence on economic growth due to globalization as argued by Birdsall et al. (2000). When we control for exports, in both fifteen year periods, middle class is negative and statistically significant. In addition, MC*PAR is positive and statistically significant at the 95% level of confidence. These findings confirm our hypothesis that higher political competition enhances middle classes' positive influence on economic growth. However, MC*PAR's petite coefficient suggests that higher political competition does not enhance the economic performance of the middle classes in a substantial and significant manner.

Why does this assertion not hold when we control for regions? One could argue that the positive effect of political competition on both economic growth and middle class performance can be observed with more clarity when countries' major exports and

regimes are taken into consideration. Ultimately, natural resource endowments and exports shape, both directly and indirectly, the political demands and preferences of the civilian population which are embodied within political competition and put into the political sphere. Controlling for regions, alone, does not provide this heated political and economic dilemma.

It is essential to note the lack of observations. This study's initial sample consisted of 136 countries, however, due to data availability, the sample dropped considerably. In addition, the use of instrumental variables resulted in a further constraint in the sample as they excluded observations according to their respective available observations. Controlling for endogeneity, however, was a crucial approach that this study undertook.

Although statistically significant results in model two support our hypothesis, the effect of political competition seems to be ambiguous. To repeat, it is intriguing to observe that political competition can be positive and statistically significant when our data simultaneously shows that countries which repress it show large levels of economic growth. Furthermore, a negative and statistical significant coefficient for the middle class is signal of a highly dysfunctional and inconsistent economic performance. Therefore, a definite explanation of the dynamic role of political competition on an economically and politically active middle class and its subsequent effect on economic growth cannot be drawn. Then, it is essential to explore the historical political and economic role of the middle class within the dynamics of political competition in certain regions and countries.

CHAPTER FIVE

THE DICHOTOMUS NATURE OF POLITICAL COMPETITION:
A BRIEF CASE-STUDY EXPLORATION

This chapter discusses the empirical results obtained in Chapter Four. It attempts to shed light on the dichotomous relationship found between political competition and economic growth. In particular, the role of the middle classes –both as active and passive bystanders- within this relationship will be explored. In order to do so, case studies in East Asian and Latin American countries will be both analyzed and contrasted. This chapter is organized as follows. Firstly, the rise of the middle classes, a product of liberalization, will be discussed in a global scheme. In the second subsection, the political role of middle classes in East Asia –with a particular focus on South Korea- will be drawn into the picture. In the third subsection, the role of political competition on middle class emergence in Latin America, with a special focus on Bolivia, will be explored. In a fourth subsection, the revolutionary uprising in the Middle East will be briefly analyzed. Finally, a fifth subsection summarizes and contrasts our observations.

A.   *The rise of a global middle class in a globalized economy*

In a highly appealing study, the scholars Milanovic and Yitzahki (2002) analyzed our world's income distribution and inequality. In search of a deeper understanding of a global middle class' general standing, they carried an analysis dividing world population in three groups: the rich (those with incomes greater than Italy's mean income), the poor (those with incomes below Western countries' poverty lines) and the middle class (those with incomes between Brazil's and Italy's mean income levels). Their findings suggest

that this partition explains about 70% of total world inequality. Their results show that 78% of world population is poor, 11% are rich and 11% belong to the middle class. These scholars conclude stating that our world clearly lacks a middle class and that, given our world's high income inequality, "it is numerically impossible to have a middle class" (p. 175).

Their assertion, although highly pessimistic, supports Quah's (1995) argument on "convergence clubs" which denies the existence of conditional convergence, claiming that middle classes worldwide are inevitably vanishing. However, it is crucial to highlight that Milanovic and Yitzhaki's (2002) study utilized data exclusively for the year 1993. Therefore, their results provide a parsimonious and static picture of middle class' emergence worldwide at the beginning of the 1990's, a decade characterized by rapid socio-economic and cultural changes due to globalization and market liberalization.

At the other end of the spectrum, Ravallion (2009) carried a more dynamic study, analyzing the emergence of middle classes in the developing world in the 1990-2005 timeline. He finds that 1.2 billion people joined the developing world's middle class, defined as those individuals living above the median poverty line. Even though this number is stunning, Ravallion emphasizes the high vulnerability of the developing world's 'new' middle classes to fall back into poverty. In addition, he highlights that *four fifths* out of these 1.2 billion people come from Asia and *half* from China. Therefore, East Asia is the region that experienced the most significant emergence of a large middle class in the last fifteen year period.

Nevertheless, what about the other regions of our planet? Birdsall, Graham and Pettinato (2000) study the effect of economic growth triggered by liberalization and

globalization on the middle classes around the world. These scholars argue that the middle classes in the United Sates, Poland and Russia experienced a decrease in the size of their respective middle classes. In contrast, they report that Latin America's middle classes increased both in size and income share *given its low starting point*. However, Birdsall et al. (2000) emphasize their vulnerability to fall back into poverty as private sector jobs have not completely compensated the losses of state jobs which were crucial to the middle classes prior liberalization.

A natural question, pertinent to the main focus of this study, arises. What is the function of political competition on economic growth, given that both East Asia and Latin America experienced considerable enlargements of their respective middle classes? In particular, could the politically active –or inactive- role of the middle classes positively influence their emergence? In order to provide potential answers to these contentious questions, it is essential to explore specific case studies.

B. *Political competition in East Asia: Middle classes' dependence on and fidelity to the State*

A crucial and intriguing question raised by both economists and political scientists is the potential development of democratization led by the middle classes in East Asia, especially in China, in the course of the 21st century. Nevertheless, current research shows that the middle classes in this region remain politically apathetic. Chen (2010), based on empirical evidence, notes that the middle classes in Singapore allow the existence of the undemocratic government as long as "it continues to satisfy's people's material needs" (p. 336). Similarly, the burgeoning middle class in Malaysia supports its

authoritarian state. In addition, Chen argues that the Indonesian middle classes prefer the status-quo of political indifference.

The Chinese Academic of Social Sciences in 2000 stated that 12% of the Chinese population belonged to the middle class. Simultaneously, the chief trade representative of the People's Republic of China predicted that the Chinese middle class would represent 30% of the total population by 2010. Motivated by this substantial prediction, Chen (2010) carried a research, surveying middle classes' attitudes towards democracy in Beijing, Chengdu and Xi'an, three prominent Chinese cities. 70% of both middle class respondents supported multicandidate elections for government leaders. Nevertheless, only 25% of respondents supported the existence of multiparty competition. In addition, a mere 24% of middle class respondents agreed "that citizens should be able to form their own organizations outside the government". Thus, Chen notes, most middle-class respondents "support the competitive, multicandidate election of leaders under the condition that these elections '*are not among several parties*'" (p. 342).

A vast number of scholars and human rights activists in the Western Hemisphere argue that middle classes' fidelity towards the State in East Asia, particularly in China, is an artificial product of despotic and highly authoritarian governments which severely and aggresively restrict political freedom. Indeed, atrocious human rights abuses have been reported in this region. Nevertheless, such assertion is clearly over-simplistic. It does not provide a fruitful explanation behind East Asian middle classes' vivid reliance on the State. Could this strong fidelity have a rational socio-economic, cultural and political rationale?

B1. 'Disciplined' Liberalization: A functional economic safe-net for the Old Middle Classes

Undoubtedly, a path towards economic development requires consistent adjustments within the socio-economic structure of nations. The European Industrial Revolution readjusted the world economy, enhancing productivity and capital accumulation through innovating inventions and mechanization which drastically improved efficiency in the production of goods and services. Urbanization became prominent in both Europe and the New World. Rural-urban migration incremented the population and economic importance of cities scattered around the globe. Thus, the primary sector of agriculture ultimately became 'secondary'. Industrialization and mass-production were at the frontier towards economic progress and development.

In the second half of the 20th century, the East Asian economies showed a remarkable and rapid transition towards industrialization. The share of the primary sector in their Gross Domestic Product (GDP) declined gradually and consistently throughout this period. Chart 5 illustratively depicts this decline. For instance, the share of agriculture in South Korea's GDP dropped from 29.2% in 1970 to 6.5% in 1995. Similarly, in these twenty five years, Thailand's primary sector declined from 28.2% to 11.1%. The share of agriculture in Malaysia's GDP fell from 30.8% in 1970 to 13.5% in 1995. A more modest decline occurred in the Philippines. The share of agriculture in this nation, as a percentage of its GDP, fell from 27.8% in 1970 to 21.6% in 1995. Thus, these nations transitioned, relatively quickly, from agrarian-based economies to successful export-oriented commercial giants.

Although highly successful in achieving higher economic growth, a transition towards industrialization has a high social cost. All those individuals who, prior industrialization, engaged in farming activities saw their livelihoods severely affected. Nevertheless, Table D depicts a unique feature of East Asian nations. The share of the Old Middle Class in these countries, constituted by small farmers and urban self-employed workers, is considerably high. For instance, South Korea's old middle class represents 34.7% of households. However, according to the scholar Val Burris (1999), this cohort of East Asian societies remains relatively loyal to the State as they "look toward strong leaders or a strong state to secure their interests for them" (p. 442). Then, a natural question arises: How could the Old Middle Classes be in political alliance with a State that, ultimately, declined the share of the primary sector in the economy?

An answer to this question is quite straightforward. The East Asian economies carried a more 'disciplined' liberalization. They did not follow the Washington Consensus – professed by the World Bank and the International Monetary Fund- devotedly. Instead, they prevented the rapid decline and economic collapse of the Old Middle Classes by imposing trade barriers to agricultural products. These protectionist policies allowed internal political stability, crucial to capital inflows for their export-oriented industries. In addition, Barris (1999) highlights that nations such as Taiwan and South Korea *encouraged* and *reinforced* the allocation of industries in rural areas in order to cushion the decline of the rural petty bourgeoisie.

This clear safe-net also benefits capitalistic endeavors. Barris (1999) argues that the old middle classes serve as subsidized labor to capitalist employers. He states that a vast number of factory employers continue to live in the country side and earn a substantial

amount of their income as part-time farmers. As a result, employers have a relatively large and cheap supply of labor as wages are simultaneously supplemented by farm income. Therefore, the survival of the old middle class can be viewed as a unique comparative advantage that East Asian economies have in the world market.

Similarly, urban self-employed workers play a fundamental role in East Asian's economies. According to Barris (1999), industrial production for export left the "informal economy" relatively intact. Casual laborers, street-venders and service workers keep wages costs down and provide inexpensive goods and services. In addition, small informal businesses are contracted by larger firms at relatively low costs. Thus, a protected and large old middle class positively contributes to capitalist profits and, simultaneously, provides a channel for upward mobility to uneducated and unskilled individuals.

Hattori and Funatsu (2003) confirm the functionality of a persistent old middle class as an efficient channel for upward-mobility. Survey studies revealed that the origin of the new middle classes –professionals, technical workers and administrative employees- is predominantly from rural and urban petty-bourgeoisie class backgrounds. In Korea, 48.6% of the new middle class was born in farming households and 62.1% reported to be from urban-petty-bourgeoisie households. In Bangkok, 21.6% of the upper white collar stratum reported to be from farming households. Studies by Academia Sinica in Taiwan have shown that these new middle classes maintain strong family ties and that their members still hold strong rural values. Similarly to the old middle classes, the new middle classes depend either directly or indirectly on the government. Whether employed

by the public or private sector, Hattori and Funatsu highlight, "the [East Asian] state became directly involved in the emergence of social classes" (p. 154).

B2. The socio-economic and cultural importance of a functional rural middle-class:

In a highly compelling book, the scholar Diane E. Davis (2004) illustrates the importance of rural middle classes in economic development. She notes that small-scale agrarian production "requires considerable self-discipline, savings and austerity" (p. 13). Then, Davis intuitively describes the emergence of early industrialized cities and countries. She strongly suggests that the "transference" of rural-based discipline into urban areas fostered economic development. Furthermore, Davis states that rural middle-classes ethos set the appropriate conditions for a strong socio-economic connection between the town and the countryside.

In addition, Davis (2004) remarks that industrialization "must be considered a rural phenomenon as much as an urban one" (p. 20). She ingeniously cites Landes' classic, *'The Unbound Promotheus.'* Landes emphasizes that the development of European city-states would not have occurred without the involvement of a sizeable and prominent rural-middle class.

Then, it is reasonable to argue that the East Asian States carried an integral program of economic development by protecting the Old Middle Classes from imminent collapse. Self-discipline and 'family values', instilled in the countryside, were ultimately transferred to urban areas. It was previously noted that the new urban middle classes have shown to withhold strong family ties and rural values. In addition, Hattori and Funatsu (2003) highlight the diligence and strong work-ethic of the new middle classes. In

Chapter Two, we displayed Josten's (2005) vision on middle classes' social networks of trust and cooperation as crucial components which strongly discourage opportunistic behavior in the economy. Thus, the protection of the Old Middle Classes in East Asia spurred positive socio-cultural externalities which contributed to the economic development in this region of the world.

B3. The case of the South Korean middle class' vacillating political involvement and potential future challenges of East Asian middle classes

South Korea was governed under highly authoritarian and restrictive governments until June 1987. In this month, the South Korean population revolted against General Chun Doo-hwan who refused to call for elections. Interestingly, however, the Korean media portrayed this event as a "*middle-class revolution*" because white-collar workers joined students' street protests. South Korea, ultimately, became democratic. About ten years later, Chun Doo-hwan was sentenced to death due to the bloody repression to the Gwangju Democratization Movement in 1980 which took the lives of 2.000 South Koreans.

What was the political stand of the middle classes during this massacre? The scholar Koo (1991), based on survey research and empirical evidence, argues that the middle classes in fact welcomed the return of Chun Doo-hwan in 1980 and remained politically passive amidst the high death-toll during Gwanju massacre. In contrast, attitude surveys before the 1987 *'middle-class revolution'* show that the middle classes became heavily dissatisfied with Chun's authoritarian government as they believed that the economic trickle-down effect was not benefiting them. Clearly, this might have been the

fundamental cause that pushed white-collar workers into the streets in June 1987, rather than a genuine desire for democracy.

Yet, in the late 1980's, economic growth slowed down in South Korea with clear signs of inflation, slump in exports and lower foreign investments. The working classes, once again, organized strikes and street protests. However, attitude surveys show that, in this particular period, the middle classes strongly criticized labor strikes. Thus, the individuals in the new middle-strata became inactive political bystanders, just as they were during the 1980 Gwanju massacre.

Koo (1991), based on the empirical evidence he illustrates, argues that "the middle classes lack political autonomy and ideology…[They] are unable to maintain a consistent political ideology [which] vacillates between the two poles [the working class and the capitalist class] according to shifting political conjunctures" (p. 492-493). His argument his highly appealing, given that the new middle classes in South Korea showed a dichotomous pattern of political affinity in just one decade. Similarly, Chen (2010) emphasizes that the middle classes in South Korea have not stimulated democracy as their interests are in alliance with those of the state elites.

Hattori and Funatsu (2003) develop a convincing argument about middle classes' passive political activism and strong alliance with the State. They argue that middle classes, in fact, lack a particular consciousness of their own given the images of affluent Western middle-classes' lifestyle which are constantly disseminated through the television and other media. In their desire to achieve similar purchasing power, status and leisure in the future, the middle classes became loyal advocates of industrialization and

economic prosperity which – in the East Asian region- were successfully carried by the State.

Undoubtedly, globalization and liberalization have not only incremented world production through the inflow and outflow of capital, goods and services. These two worldwide phenomena have also drastically reshaped the conception of what being 'middle-class' truly is. Hollywood movies, Western entertainment, reality shows in the TV and social networks –among many others- have either directly or indirectly standardized the standards of leisure, progress and advancement which are eagerly and diligently pursued by the middle classes. Thus, the devoted alliance of middle class individuals with the State seems reasonable.

Middle classes in this region, however, face potential challenges in the future. So (2004) states that a feeling of downward mobility exists within the East Asian middle classes. Furthermore, this scholar notes that globalization has also intensified competition within middle classes across borders. For example, mainland Chinese middle classes compete for jobs in Hong Kong, whereas Hong Kongers compete for jobs in mainland China. As migration intensifies competition, So argues, wages and benefits for middle-class professions are ultimately lowered. He warns that such competition could increment the heterogeneity and fragment the Asian middle classes due to ethnic diversification within the labor market, causing a profound impact on middle classes' identity, life-style and political views.

So (2004), intuitively, highlights: "In this globalization era, one country's middle class no longer exists in isolation from another's. It is inevitably influenced by middle classes in adjacent countries and in the region" (p. 273). Without a doubt, globalization

and the media have allowed this phenomenon to occur at a fast speed. A vivid current illustration, as of June 2011, is the spread of revolutionary movements in the Middle East –which will be discussed briefly by the end of this chapter.

C. *Latin America's politico-economic history: A painful transition to relative stability*

In Chapter Two, we analyzed the difficulty of Latin American nations to set appropriate conditions for the emergence of middle classes given their natural resource endowments and process of colonization as discussed by Engerman and Sokoloff (2002). Indeed, after their independence, Latin American nations inherited inefficient institutions, a large pool of impoverished individuals and a small oligarchy which was reluctant to invest in human capital accumulation.

"Political Competitiveness," the variable utilized as a measurement for political competition in Chapters Three and Four, clearly and accurately depicts the Latin American historical politico-economic dilemma. Almost every single Latin America nation (with the clear exception of Costa Rica) reports a constant score of *three* throughout their independent lifespan. The Polity IV Project's basis for this low score notes:

> "**(3) Factional:** Polities with parochial or *ethnic-based* political factions that regularly compete for political influence *in order to promote particularistic agendas and favor group members* to the detriment of common, secular, or cross-cutting agendas."

This ranking and its description genuinely correlate with the rise and fall of Latin American dictators, political parties, short-lived pseudo-democracies and social movements which hampered economic growth and constrained the consolidation of functional and sizeable middle classes throughout the 20th century. Ethno-politics greatly

benefited the oligarchs from European descent at the cost of the indigenous and impoverished populations which remained at the bottom of the socio-economic pyramid. In addition, Latin American revolutions were characterized by the implementation of cosmetic reforms which successfully satisfied short-run expectations but proved to be highly unproductive in the long-run.

For example, the *Movimiento Nacionalista Revolucionario* (MNR) party –in coalition with the miners and indigenous peasant masses- carried a revolution which overthrew the Bolivian political oligarchy in April 1952. Victor Paz Estenssoro, leader of the MNR, became president and implemented drastic politico-economic reforms. He granted universal adult suffrage, universal education and nationalized Bolivia's mines and industries. In addition, The *Central Obrera Boliviana* (COB), the workers' union, was founded and became a fundamental pillar for Paz Estenssoro's first presidency. Last but not least, the MNR distributed land ownership permits to the peasantry, thus breaking the colonial-feudal system of *haciendas*.

Nevertheless, Bolivia's 1952 land reform was unsuccessful in the long-run. Indigenous rural peasants lacked both the productivity and factors of production to truly benefit from land ownership, which negatively affected their standards of living. Furthermore, the model of Import Substitution Industrialization (ISI) prioritized the mining industry over the agricultural sector, thus preventing the diversification of the economy and leaving the indigenous peasantry in ruin. Mexico's 1910 revolution and others in the region faced similar misfortune.

The strong coalition between unionized workers and the Latino States, however, was short-lived. The political support of powerful labor groups brought within strong wage

bargaining and rigidity. These factors prevented crucial macroeconomic adjustments to negative external and internal shocks which inevitably triggered inflation and lowered economic growth. As a result, bloody military governments and dictatorships emerged which, through repression and unmerciful massacres, brought real wages down and artificially maintained internal stability. Thus, democratic transitions became sporadic and unstable phenomena which, in general, lacked legitimacy. Political competition was suppressed and rigorously controlled by dictators who eagerly refused to give up their politico-economic power.

In the beginning of the 1980s, however, Latin America was bankrupt. Skyrocketing levels of inflation, high levels of unemployment, and poor economic performance proved that ISI was clearly dysfunctional and ineffective. Thus, in this decade, a wave of democratization emerged after the inevitable fall of dictators. Simultaneously, most of the Latino countries liberalized their economies and devotedly followed the Washington Consensus which promised to foster macro-economic stability and boost economic growth.

Interestingly, however, those political parties that initiated ISI and led the revolutions were the ones that ultimately implemented the Washington Consensus (*Accion Democratica* in Venezuela, *Partido Revolucionario Institucional* (PRI) in Mexico and *Peronismo* in Argentina). Victor Paz Estenssoro, in his fourth presidency and advised by Jeffrey Sachs, implemented the Decree 21060. This policy liberalized Bolivia's economy controlling a skyrocketing hyperinflation and boosting economic growth.

Nevertheless, Sachs' *shock therapy* inflicted a high social cost on the Bolivian population. The state miners and white-collar workers who formerly worked on state-

owned industries and offices were left jobless. "*La marcha por la vida*" ("March for Our Lives") in 1986 is an epitome of this painful and acerbic social effect. Five thousand Bolivian miners –accompanied by their children, wives and relatives- marched more than hundred kilometers by foot to La Paz demanding the cancellation of the Decree 21060 which crushed their *Modus Vivendi*. Fortunately, Estensorro's government prevented an imminent bloodshed between the miners and the militia. However, Bolivia's '*old middle classes*' were abruptly dissected from the socio-economic sphere. Similar and parallel stories can be drawn across the Latin American countries which drastically adopted Sachs' *shock therapy*.

The efficiency of macroeconomic adjustments and further economic growth promised by the IMF and the World Bank, however, were temporarily successful. Rodrik (2006) highly criticizes the implementation of the Washington Consensus in Latin America. He notes that Latin America's GDP per capita growth during the 1990's was much lower than in the 1950-1980 timeline. In addition, he reckons that Argentina "the poster boy of the Latin American economic revolution" (p. 975) crashed in 2002. Similarly, Brazil's devaluation in January 1999 proved that Washington's political reforms were ineffective.

The efficacy of the Washington Consensus for Latin America's recovery is still subject to scholarly debate. On the one hand, economists such as Rodrik (2006) and Easterly (2005) heavily criticize the Washington Consensus for its predatory effects on Latin America's recovery. On the other hand, Jeffrey Sachs and other Washington Consensus' advocates argue that liberalization was the only viable solution for Latin America's general state of bankruptcy. Nevertheless, corruption, the incompetence within

Latin American politics and lack of functional conflict-management institutions are plausible reasons for the economic relapse in the region.

Graham (2000) discusses the role that political parties played during the implementation of the Washington Consensus. She states that the elites of Latin America's mass political parties were primarily focused on establishing political pacts that would safeguard the transition to democracy. Nevertheless, in the process, they had little appeal for the poor who were severely affected by liberalization and the debt crisis that followed. Indeed, the cohort of the Latin American population which was negatively affected by liberalization is easily identifiable. However, those who are benefited from market reforms are more difficult to recognize.

What political role did Latin American white-collar workers played in the implementation of these reforms? Birdsall, Graham and Pettinato (2000) argue that the middle classes were initially relatively receptive of market reforms, unlike the 'old middle classes' which were severely affected. These scholars state that the unpleasant experience of high levels of inflation motivated the middle classes to be more supportive of market reforms. Nevertheless, they highlight that once these were established, the middle classes became highly preoccupied and critics to socio-economic issues such as job insecurity, under-provision of public goods and income inequality.

As a result, the late 1990's and the first five years of the millennium were scenarios for high levels of political instability in the region. The already mentioned Argentine and Brazilian crisis inflicted negative economic shocks to neighboring countries. Argentina, for instance, had five presidents in the 1999-2003 timeline. The fall of the democratically elected Argentine President, Fernando de la Rua, is attributed to a general revolt amidst

the Banking crisis in December 2001. The Argentinean middle classes, which were negatively affected, massively joined the working classes' street protests.

Similarly, Ecuador underwent a deep politico-economic crisis. This Andean nation had seven presidents between 1996 and 2007. The Ecuadorian Banking crisis which initiated in 1998 spurred into a conflictive social turmoil. The Ecuadorian middle classes in Quito organized a popular upraising known as "*La Rebelion de los Forajidos*" demanding the resignation of the democratically elected president Lucio Guitierrez in April 2005. Amidst his attempts to repress the massive revolt Gutierrez was forced to resigned, seeking political asylum in Brazil's embassy.

Bolivia, between 1997 and 2005, had six presidents. The second presidency of Gonzalo Sanchez de Lozada, a co-designer of Estenssoro's Decree 21060, was overwhelmed by political instability. In October 2003, a popular uprising emerged against Sanchez de Lozada's decision to export Bolivia's natural gas reserves through a Chilean port. About eighty people were unmercifully killed. The Bolivian middle class supported the working classes, organizing hundreds of hunger strikes scattered around the country, demanding Sanchez de Lozada's resignation. This unpopular president resigned and fled to the United States, where he has found political asylum given his American citizen status. Despite the constant efforts of Bolivia's Justice Court and pleas for extradition, Sanchez de Lozada's crimes remain unpunished to this date.

Majetu (2000) argues that voting preferences for leftist governments depend on the subjective downward mobility perceptions of individuals. Thus, other things kept constant, the larger the pool of individuals who believe themselves as losers, the stronger the likelihood for left-wing parties to win elections. Certainly, Majetu's argument sheds

light on the recent emergence of leftist governments in Latin America. Rafael Correa, Ecuador's leftist president, won elections in 2006 with 57% of the popular vote. Similarly, Bolivia's leftist Evo Morales won elections in 2005 with 54% of the popular vote. The Kirchners in Argentina, characterized by their socialist politico-economic policies, gained popular support. Lula Da Silva in Brazil and Hugo Chavez in Venezuela, are also clear example of the raise of socialism in Latin America. A profound sentiment of downward mobility and frustration among the Latin American middle classes, as argued by Birdsall et al. (2000), can explain their strong political support for the consolidation of left-wing governments in the region.

Nevertheless, how has Latin America performed economically after this conflictive politico-economic instability? According to the *Economist* (2010), Latin America has shown its best economic growth –since the 1960's- between 2003 and 2008 as it averaged 5.5% a year. Furthermore, a special report on Latin America's responsiveness to the 2008 Financial Crisis carried by the OECD (2010) shows that the region has responded relatively well. Graph A depicts the recessionary impact of the crisis in Latin America and the OECD. Although Venezuela and Mexico were the most affected by the crisis, the region's overall long-term economic prospects remain positive. Latin America's GDP fell by 1.8% in 2009, in comparison to the OECD countries which experienced a 3.5% drop in their growth rate. In comparison to the economic relapse after the 1980's debt crisis, the OECD (2010) report highlights that Latin America performed positively both at the micro and the macro levels of the economy in 2009.

In addition, the OECD (2010) emphasizes that sound macroeconomic policies and economic growth since the early 2000's have reduced a decline in income inequality and

poverty in most Latin American countries. As a result, the Latin American middle classes have been created and enlarged. Nevertheless, what is the socio-economic and political composition of Latin America's middle classes?

C1. The Latin American Middle Class: Informal, Vulnerable and Politically Expectant

The OECD (2010) special report on Latin America's middle classes defines the middle sectors as those individuals with incomes ranging from 50% to 150% of the median. According to this definition, 275 million Latin Americans – which represent under half of the total population-, were middle class in 2006. Graph B illustrates the socio-economic composition of ten Latin American countries with the inclusion of Italy for matters of comparison. It is important noting that these ten countries cover more than 80% of Latin America's total population. The proportion ranges from 56% in Uruguay – the highest- to 37% in Bolivia –the lowest percentage. Nevertheless, the *Economist* (2010) notes that many of those considered middle class by the OECD (2010) report would be considered impoverished under developed countries' standards. The median annual income ranged from $2,820 in Bolivia to $6.036 in Mexico, whereas the Italian median income was $18.816.

Graph B however, provides a parsimonious picture of Latin America's middle classes nature and composition. The OECD (2010) report highlights that the middle classes in Latin America are economically vulnerable and risk falling down the socio-economic ladder. Latin America's high levels of income inequality, rent-seeking and informality persist. According to this study, the absolute number of Latin American middle class individuals in the informal sector of the economy is considerably high. Graph C

illustrates the decomposition by employment and income group in Bolivia, Brazil, Chile and Mexico.

According to the OECD (2010), 44 million out of 72 million middle-sector workers in these countries are engaged in the informal sector. Nevertheless, most of Chile's middle classes work as formal employees. In contrast, Bolivia's formal employees represent a mere minority in the middle-sectors. Although formality is more prominent in Mexico and Brazil, informality remains prevalent among the middle classes in these countries. It is worth noting that affluent self-employed workers (with tertiary education) are also engaged in the informal sector. This factor is a clear sign of inefficient labor-law enforceability. Low tax collection, due to the existence of a prominent informal sector, leads to a lack of social-security and an under-provision of public goods in the region.

In terms of education, the OECD (2010) states that the Latin America's middle sectors most common level of education attainment is the completion of secondary education. Furthermore, it is stated that tertiary education is a privilege of the affluent cohort which faces little risk of downward mobility. In contrast, the most impoverished cohort is benefiting largely from initial educational attainment. Nevertheless, the OECD report highlights, the middle classes "seem to remain trapped, unable to break into tertiary education" (p. 126). In addition, the *Economist* (2010) emphasizes that the children of poor households – especially those in rural areas and of black or indigenous descent- are less likely to complete schooling that the average Latin American.

The investment in private education is prevalent among the Latin American middle class and affluent sectors. The inefficient public education forces entrepenurial parents to enroll their children in private schools. Nevertheless, according to the *Economist* (2010),

the six Latin American countries that took part in the OECD's Program for International Student Assessment (PISA) study ranked "in the bottom third of the 57 countries covered" (p. 14). Thus, the quality of education in Latin America remains below the standards of both developed and developing nations.

The convergence between support and satisfaction for democracy in Latin America is not firmly consolidated. Clearly, the Latin American population supports democracy given the pat socio-economic and political trauma of bloody and repressive dictatorial regimes. Nevertheless, their satisfaction with how democracy actually functions is remarkably low.

Interestingly, the Latin American middle classes generally position themselves in the center of the distribution of political preference between extreme left and extreme right. Graph D depicts this interesting observation. 54% of the Latin American middle classes positioned themselves between 4 and 6 (the political center). Furthermore, this socio-economic cohort displays lower dispersion in political preferences in comparison to the affluent and the impoverished. Thus, the OECD (2010) states, the middle classes in Latin America withhold moderate views on politics. They support it yet "remain dissatisfied with how democracy actually functions" (p. 152). Therefore, the middle classes prove to be relatively passive and expectant to the shifts of politico-economic conjectures. In short, they seem to have a "dissatisfied customer relation" with the state: although relatively supportive of taxation, they are dissatisfied with the public goods and services they receive (ibid). In terms of consumer goods, they aspire to six Cs: *casa propia* (a home of one's own), a *car*, a *cell-phone*, a *computer*, *cable television* and trips to the *cinema* (The Economist, 2010). However, their economic vulnerability intertwined with

an under-provision of public goods and services make their aspirations difficult to fully materialize.

C2. Bolivia: the Collapse of Traditional Political Competition and the emergence of an unstable Populist Political Competition

The fall of the MNR and Gonzalo Sanchez de Lozada in October 2003 also proved to be the end of traditional political parties in Bolivia. Coalition between traditional parties defined the fate of the popular presidential vote in the Congress. Nevertheless, these were safe-havens of corruption, inefficiency, the status-quo and illegitimate political contradictions among political leaders.

A clear example is the election of Jaime Paz Zamora as president of Bolivia in 1989. He ended third in elections. Nevertheless, ADN –the political party of the former dictator Hugo Banzer- offered support in the congress to block Sanchez de Lozada, the first finisher in elections. Paz Zamora accepted and was elected president by the Congress. Ironically, Paz Zamora vowed never to cooperate with Banzer as this dictator persecuted and tortured many of his political colleagues in the 1970's. Nevertheless, when the opportunity materialized, Paz Zamora renounced to his ideals and convictions and took advantage of this political opportunity.

Political competition between several parties severely fractioned the popular vote and lead to the emergence of coalitions. The process and functionality of coalitions reached exorbitant levels. For instance, the former dictator Hugo Banzer created a "Mega-Coalition" between his party and six others (ADN, MIR, UCS, CONDEPA, NFR and FRI) in order to be elected president by the congress in 1997. Ministries, state offices and

embassies were distributed among the governing parties. Political nepotism emerged in these institutions which severely damaged their productivity and functionality as employers were constantly changed. In addition, professional development through experience in this unstable scenery is proven to be difficult for the labor force. Thus, human capital accumulation was severely hindered in the public sector which negatively affected its overall competence.

The monopoly of traditional political parties, indeed, made the emergence of small political parties difficult. Evo Morales, leader of the coca-leaf growers and backed by social movements, founded a political party *Movimiento al Socialismo* (MAS) and ran for president in the 2002 elections. Initially, preliminary polls showed that Morales' candidacy lacked support. Nevertheless, the then US ambassador Manuel Rocha warned "As a representative of the United States, I want to remind the Bolivian electorate that if you elect those who want Bolivia to become a major cocaine exporter again, this will endanger the future of U.S. assistance to Bolivia" (El Diario, 2002).

This statement had an unexpected effect. Morales' ended up second in elections with 20.9% of the popular vote and only two percentage points below Sanchez de Lozada. Through a coalition with NFR and other minor parties, Sanchez de Lozada was positioned president. Nevertheless, the emergence of Morales and MAS as a strong and influential opposition marked the twilight of traditional parties.

During the social movements in October, 2003, Morales constantly appeared in the media demanding publically Sanchez de Lozada's resignation and justice for the atrocious human rights abuses that were committed under his rule. Carlos Mesa, Sanchez de Lozada's Vice-president, became president. In his presidency, Mesa broke the

monopoly of political parties. Under a decree, Mesa reestablished the rules for political competition and participation. Bolivians were now able to form independently "Citizenry Organizations." 2.000 firms and a clear plan of organization sufficed for the formation of small new political parties. In addition, especial grants were given to "Citizenry Organizations" formed by indigenous populations. Although indirectly, Mesa's policy granted direct political power and influence to social movements which previously were merely demanders of political reforms.

After two years, due to political instability and general insurgence, Carlos Mesa resigned in 2004. The president of the Judiciary System, Eduardo Rodriguez became president and called for elections in 2005. Morales, unquestionably, was the favorite to become president. As previously noted, he won elections with 53% of the popular vote. Clearly he gained support from white- collar workers constituted by professionals and intellectuals. In addition, middle class workers in the informal sector and loyal social movements pledged their allegiance with the Morales' rule.

A recent finding by the United Nations' Human Development Program, released in November 2010, stated that Bolivia's middle sectors have considerably increased in the last decade. Between 1999 and 2007, the middle class in this Andean nation grew from 2.4 million people to 3.6 million. Thus, this increment suggests that the middle class increased in six percentage points −from 30% to 36%- of the total population. In addition, the report suggests that 40% of this new socio-economic cohort is indigenous. According to this study, about 138.000 people are lifted out of poverty every year to join the middle sectors. Nevertheless, the UN warns Morales that the high levels of income inequality are comparable to those recorded in the 1970's (Mery Vaca, 2010).

Indeed, the statistics are astonishing. The fact that 138.000 people join the new Bolivian middle class every year is a promising and optimistic figure. However, this study shows that 2.3 million out of the 3.6 million individuals that joined the middle are vulnerable to fall back into poverty. Therefore, it is essential to consider the limitations of these significant yet severely endangered improvements.

The large increase in middle classes in Bolivia and the rule of Morales, however, prove to lack sustainability. By the end of December 2010, Morales with the implementation of the Decree 748, removed the subsidies on fuels which lead to raising prices by over 70%. The government argued that it was no longer capable to cover the subsidies as it costs about $380 million a year. This caused a severe and drastic increment on the price of goods and services in the nation.

A general uprising occurred after the implementation of the Decree 748. The social movements, formerly loyal to Morales, protested massively in the streets. The middle classes, constituted by informal workers and professionals, joined the revolts. Interestingly, a massive protest against the Decree 748 was organized via Facebook. Initially, Morales claimed that the implementation was irremovable. Nevertheless, the social turmoil surpassed Morales' expectations. The Decree was abrogated three days later. These unsuccessful policies indirectly spurred inflation which is at 8.4% (The Economist, 2011a). The *Central Obrera Boliviana* (COB), through violent protests in La Paz, is currently demanding raises in wages to keep up with inflation.

Morales, several days after the abrogation of the Decree 748 stated "Myself, my ministers and my government are not held responsible for the economic future of the nation… fuel subsidies is a cancer for the national economy" (La Razon, 2011).

Nevertheless, he later stated that the Bolivian population "was not ready and that the population should be prepared in advance for future increments of prices" (ibid). A poll taken in Bolivia's main cities after the abrogation of the Decree 748 has shown that Morales' popularity dropped from 64% in November 2010, to 48% in December 2010 and to 36% in January 2011 (La Razon, 2011).

The unsuccessful attempt of Morales to stabilize Bolivia's fuel prices to international prices and the massive revolt that emerged should be carefully considered as a cautionary case study for the future of developing nations worldwide. Indeed, the UN applauded the raise of the middle classes in this Andean nation which is an optimistic sign of development. Nevertheless, its unsustainable nature is preoccupying. Morales, although popular, is currently undergoing a deep politico-economic crisis. The enlargement of the middle classes in Bolivia has proven to be ineffective safe-nets. Given its low purchasing power, despite its evident enlargement, this social cohort remains clearly economically vulnerable to both internal and external shocks.

D. Revolutions in the Middle East: The Lethargic Middle Class Awakens

The Economist magazine issued by the end of July, 2009 displays a picture of a young Arab child holding his fathers' hand in the desert. Turning their back to the reader, both figures view a deserted beautiful horizon. In an almost prophetical title, this magazine portrays "Waking from its sleep: A 14-page special report on the Arab World." In this report, the word revolution is mentioned several times. Undoubtedly, the Economist foretold in advance with certain precision, just as Nostradamus' quatrains, what was going to unfold in this region of the world about two years later.

When this study was under an already advanced process of development, the revolutions in Tunisia and Egypt erupted. Although not directly linked to this study's main aim of analysis, the unprecedented socio-cultural process that the world witnessed in the Middle East is suitable to middle class analysis. As discussed in Chapter Two, Acemoglu and Robinson (2000) argued that the Western European Elites extended the franchise to the middle classes in order to prevent revolutions. Thus, a parallel story can be drawn into the Middle Eastern case: the Arab authoritarian regimes of Mubarak and his neighboring companions clearly underestimated the local middle classes' political demands and desire for democracy. Similarly, Bourguingon and Verdier (2000) argued that an oligarchy is willing to promote the rise of an educated middle class in order to boost economic growth. Nevertheless, as a result, the oligarchy's political power ultimately decreases as political participation is positively related to educational level. Thus, it is plausible to argue that higher levels of education in the Middle East triggered the revolution. Certainly, thousands of Arab youngsters and university students were the main organizers of revolts. Their medium of their organization, however, sheds light on the effects of modernization and globalization on middle class' consciousness. Facebook was the political channel and *modus operandi* utilized by these young revolutionaries.

The emergence of an "Arab Middle Class', as a socio-economic and cultural term, has not been sufficiently scholarly analyzed in the Middle East. Keith David Watenpaugh (2006) in a highly compelling and well-written book, "Being Modern in the Middle East", studies the historical development of the middle classes in the Eastern Mediterranean. He reckons that the term 'middle class' in early Middle Eastern

historiography lacked particular attention as it is was vaguely and constantly mentioned in footnotes.

According to Watenpaugh (2006) the terms 'bourgeoisie' and 'middle class' began to be translated into Arabic, Ottoman Turkish and Armenians in the 1900s. Nevertheless, these terms were used as descriptive categories in journalism, official documents and popular writing (p. 20). Rather, the Middle Eastern literature focused on the role of the *effendiyya*. This social cohort constituted of "young men educated in the West, wore Western-style clothing and emulated European lifestyles." Secondary and university students, teachers, lawyers, journalists and other white-collar workers fell under this description (p.17). Thus, it could be argued that the Middle Eastern society adopted a term of its own in order to understand the emergence of a heavily Westernized middle class. By doing so, the Arab world maintained its autonomy from Western culture.

Watenpaugh's (2006) main argument is that a discrete middle class emerged not solely by their income levels and professional occupation but also "by the way they asserted their modernity". He defines modernity as a collection of "ideas about the individual, gender, rationality, authority, society, mores, manners, culture" and how "these actively derived from contemporary metropolitan Western middle classes" (p. 8). Furthermore, Watenpaugh argues that in this process, a middle class conceived themselves different from the ruling Sunni Muslim oligarchy and the lower classes. In short, this scholar states that the Middle Eastern middle class emerged given its profound desire to be just as modern as white-collar workers in Europe.

Watenpaugh (2006) makes an interesting statement. He argues that "the middle class is not just a byproduct of industrialization, but that its appearance can be understood in

the context of new kinds of *communicative technology*, transportation, urbanization; and while classes emerge, they are also made and remade" (p.20). Indeed, globalization and the information era have interconnected individuals more than ever. However, a fairly recent and drastic revolution in communicative technology has emerged. And that is Facebook.

As previously noted, Facebook was the medium that the young revolutionary middle classes in the Middle East utilized for their endeavors. Most certainly, it facilitated and safeguarded their organization as the revolutionaries remained partially hidden from political control and law-enforcement. Nevertheless, it should be remembered that Facebook is more than a simple platform that facilitates the exchange of messages –such as e-mail. It is a *social network* that allows people to share valuable personal information to the public via pictures. And, within this precious stock of information, images of affluent Western middle-classes' lifestyle are proliferated.

For example, consider an Egyptian student who went to university in France in the 1950s. Enchanted and influenced by Western modernization and lifestyle, he became an *effendiyya*. Nevertheless, upon his return to Egypt in the 1960s, he idealized Europe's advancement. Nevertheless, unable to keep in touch constantly with his French peers, his idealism and views on Europe dissipated as time progressed. Assuming that he was not to return to Europe anymore, inevitably, his idealism remained in mere aspirations. In the end, his socio-economic conceptions would have assimilated the traditional local, Middle Eastern, Arab and/or Muslim culture.

In contrast, compare such imaginary –yet fairly realistic- example with the current flow of international students in the new millennium. Consider an Egyptian student who

goes to university in France. Enchanted and influenced by Western modernization, he also become and *effendiyya*. Upon his return to Egypt in 2010, however, he is able to share his personal experiences to others through *hundreds* of pictures via Facebook. These images carry a strong socio-economic and cultural content as it materializes affluent Western middle-classes' *modus vivendi*. Assuming that he is not to return to Europe anymore, he is capable to maintain friendships, formal and professional relations. Thus, his socio-economic conceptions might be able to trespass the boundaries of time and space and, in fact, proliferate in his community.

Early in this chapter, we mentioned that images of affluent Western middle-classes' lifestyles have ultimately reshaped the conception of what being 'middle class' truly is. Prior globalization, this was defined *within* societies, according to their particular socio-economic and political structures. In a globalized world, however, middle class has become a more standardized concept. Patterns of higher purchasing power, status and leisure are channeled through common global trademarks such as Adidas, Puma, Channel, Benetton and Mercedes Benz or Toyota. Nevertheless, scholarly discussions – typical of educated middle classes- may raise common themes such as freedom, liberty, politics, oppression, corruption and modernization.

The *Economist* (2011b) stated that the Middle Eastern revolutions might have occurred due to a "growing gap between the regimes' antiquated world views and the sophisticated outlook of their people." Besides higher levels of education, Facebook and the internet might have contributed to widen this gap even further as these technological tools strengthen communication through messages, pictures and images with both explicit and implicit political content. A vivid example of the power of pictures in the revolution

was expressed by Walid Rashed, a young revolutionary. He said that the missing element in his generation was pride. He claimed "We were always looking at photos, but were never in the picture, now the photo is us." (The Economist, 2011b)

What photos was Rashed particularly referring to? Could it be classic textbook pictures which display classic pictures drawn by artists of the 1789 French Revolution? Or, perhaps, was Rashed referring to more colloquial photos of *free* affluent American or European acquaintances capable and able to vote, thus, deciding their future? Maybe, a most parsimonious and fair answer is a juxtaposition of both types of photos.

Most certainly, the elusive middle classes in the Middle East have awakened from their sleep. Nevertheless, as the Economist (2011b) states, the Middle Eastern revolutionary youth lacks political experience. The formation of political parties seems difficult given that new forces are constantly emerging. Creating a revolutionary Facebook group requires several clicks. In contrast, building a stable, competent and competitive political party requires more coordination. Could a functional political competition thrive in the Middle East? If so, what role would the middle classes play? These questions, for the time being, should remain unanswered. Nevertheless, our worlds' hopes and optimism for a brighter and more peaceful future fall on the yet conflictive Middle East.

Summary

In this chapter, the case studies of East Asia and Latin America shed light on our empirical results obtained in the previous chapter. East Asian middle classes remain loyal and faithful to their respective states given their successful trends of upward mobility. In

addition, they are shown to be relatively politically apathetic. However, as in the South Korean case, the middle classes have a tendency to display dichotomous and vacillating political attitudes when their interests are endangered. Overall, it seems that the middle classes in East Asia would prefer benign authoritarianism over chaotic democratization as long as their demands for materialistic needs, standards of living and status are maintained. High levels of economic growth and development could ensure their loyalty.

At the other end of the spectrum, the enlargement of the Latin American middle classes is contingent to their socio-economic vulnerability. Even though the informal sector has allowed their emergence, it has also severely constrained the provision of public goods and social security. Their negative experience with dictatorial authoritarianism in the past prompts the middle classes to be supporters of democracy. However, a sentiment of dissatisfaction with how actually democracy functions is prevalent among the Latin American middle classes. In a similar fashion to the East Asian middle classes, they remain at the political center and dependent on the politico-economic conjunctures that eventually erupt. Nevertheless, they have shown higher levels of political activism given the constant politico-economic and social instability which infamously characterizes the Latin American region.

Although different in nature, composition and purchasing power, both the Latin American and South Korean middle classes show commonalities in their aspiration to acquire material goods and status. A globalized economy has interconnected individuals, standardizing patterns of consumption behavior characteristic of affluent Western middle classes.

Perhaps, a fundamental factor that differentiates these two regions more markedly is the relative well-being and functionality of their 'old middle classes'. On the one hand, East Asia did not follow the Washington Consensus, thus protecting the collapse of their old middle classes. As a result, the East Asian states were capable to partially integrate this socio-economic cohort into a market-liberalized economy. On the other hand, the Latin American 'old middle classes' were dissected from the economy once this was liberalized. This incurred into a painful and long-lasting social cost, a sizeable yet vulnerable informal sector and internal socio-political instability. In short, the secret success of East Asia might lay on the fact that the dead-weight losses – 'the old middle classes'- became functional with liberalization. Conversely, in the Latin American case, the dead weight losses were drastically and severely dissected by a standard *shock therapy* procedure.

The revolutions in the Middle East, due to their recent development, provide grounds for theoretical analysis of middle class' emergence and involvement. The world has witnessed the emergence of vibrant middle class, eager to benefit from democracy and globalization. Nevertheless, the future of political competition and its success remains uncertain. A clearly distinguishable, and perhaps ground-breaking, factor is the use of Facebook and the internet as political channels of *modus operandi*. As result, *social networks* have proven their prevalence not only for entertainment. They have naturally become both important databases and topics of studies for future politico-economic research.

CHAPTER SIX

CONCLUSIONS

This chapter summarizes the conclusions of both econometric estimations and case studies' explorations. In addition, it proposes policy implications and suggestions for further research.

A. Summary of Findings

Using cross-sectional data from the World Bank Development Indicators (WDI), the Polity IV Project, Freedom House and the Barro & Lee data set, this study investigates whether a politically active and sizeable middle class is more likely to contribute positively to economic growth. In contrast to previous studies in the literature, this study uses countries' relative level of political competition as a measurement of middle class' political involvement. This paper uses two instrumental variables to control for endogeneity between economic growth and middle class. Furthermore, case studies in Latin America and East Asia were explored.

This paper' empirical results find a dichotomous effect of a politically active middle class on economic growth. On the one hand, evidence shows that political competition enhances the positive impact of middle class on economic growth. On the other hand, the repression of political competition, and the subsequent political inactivity of the middle class, is positively related to economic growth.

Case studies in Latin America and East Asia shed light on these results. Even though these two regions have experienced considerable enlargements in their respective middle classes, their political and economic role differs substantially. On the one hand, the

relative political inactivity of East Asian middle classes is contingent to successful macro-economic policies carried by their states which fostered large levels of economic growth. On the other hand, the relatively active political standing of the Latin American middle classes is product of the constant politico-economic instability in the region which tends to negatively affect this vulnerable socio-economic cohort. Nevertheless, the middle classes in both Latin America and East Asia share clear and interesting commonalities. *Ceteris paribus*, the middle classes in both regions are politically neutral, apathetic and their political activism depends on specific politico-economic conjectures. Furthermore, they seem to have similar demands for public goods and analogous aspirations for leisure, private goods and desire for upward mobility.

The political and economic state of the Latin American middle classes disproves Easterly's (2001) middle-class consensus which states that a *larger* middle class is positively related to economic growth. Even though reports by the United Nations and the OECD show that these socio-economic cohort has increased in both size and share, the Latin American middle class remains in the informal sector and is vulnerable to downward mobility. As a result, this larger middle-income stratum might not properly function as a safety-net amidst internal and external negative shocks.

In synthesis, middle classes' political inactivity might be viewed as positive economic sign. As long as their needs and demands are relatively satisfied, middle class individuals tend to remain at the margin of the political sphere, thus fulfilling their economic role as drivers of economic growth. Conversely, a highly politically active middle class might be an alarming sign of inefficiencies within the socio-economic system as their needs are not being satisfied. Political involvement of the middle classes might carry within itself a

high opportunity cost for the economy: a dysfunctional safety-net which is more preoccupied demanding political attention rather than fulfilling its most important role which is enhancing further economic growth. It is essential to note, however, that these assertions highly depend on the historical overall economic performance of the country, the *quality* of political competition and the social contract.

B. *Policy Implications*

The development of Latin America's middle may be considered as a cautionary tale for other developing countries with emerging middle classes. Indeed, it is necessary to lift people out of poverty. Nevertheless, it is as essential to guarantee their upward mobility into the formal sector during their transition. Although enlarging the size of the informal sector is effective at disguising unemployment and serves as an income generator to individuals, it might not precisely be a sustainable developmental outcome. Low taxation rates and vulnerable jobs perpetuate the vicious circle of poverty as public goods remain under-provisioned. Improving the *quality* and extending the provision of public goods to the middle sectors could better the middle sectors' vulnerable economic standing.

Governments in the world may want to consider the sustainable increase of their middle classes. A larger middle class might not necessarily guarantee its proper functionality. Our exploration into the state of Bolivia's middle class partly showed this phenomenon. Although the Bolivian middle class' income share and size have increased, they have shown to be ineffective in their role as socio-economic safety-nets. Furthermore, this optimistic statistic could be used by politicians for incumbent purposes with the absence of solid socio-economic foundations. Thus, governments are entitled to

research the evolution of middle classes meticulously throughout time in order to shape sustainable long-run developmental policies which are in accordance to the middle classes' socio-economic demands. As argued by Birdsal et al. (2000), "it is the political support and economic participation of those in the middle class that will be critical to market-driven economic growth and thus to poverty reduction in the long run" (p. 19-20). Furthermore, our case studies in East Asia and Latin America showed that middle classes tend be politically apathetic. Thus, although difficult in practice, it would be practical and highly beneficial for governments to hear the middle classes' demands *outside* the political sphere. With more pragmatic information, more pragmatic policies can be designed. A Non Governmental Organization (NGO) could carry such important task. In the end, the politically central and incumbent uninterested yet diligent and hardworking know what is best for the economy. They are the experts. They should be asked.

The future prospects of middle class' emergence worldwide are both alarming and hopeful. Bussolo, Hoyos and Medvedev (2009) predict that, by 2030, 429 million Chinese will be in the global middle class (in comparison to mere 56 million in 2000). They state that in 2000, the middle class and the rich exceed 40% of the population in just six developing countries, accounting for only 0.8 of the total population in the developing world. However, by 2030, the middle class and the rich will exceed 40% of the population in 34 countries and that these will account 39% of the worlds' developing population.

The emergence of such sizeable middle class, without any sort of control, might be potentially dangerous. The world, quite bluntly, cannot have the privilege to worsen its income inequality even further, given the severity of ongoing global issues such as

climate change, terrorism and widespread of revolutions. Perhaps, a ninth New Millennium Goal is to be designed. Or, at least, a new clause could be added to the first one which emphasizes the eradication of extreme poverty. Such goal should oversee the emergence of the new middle classes in order to assure its empowerment as a *global* driver of economic growth. Perhaps, our world will be a better place to live if all governments could simultaneously cooperate on this endeavor, forgetting for an instant their borders. In the end, the emergence of a global middle class is a global phenomenon which affects the entire globe both positively and negatively.

C. Suggestions for Future Research

First and foremost, economists face should come to a solid consensus on how to define and to measure middle class. A difficult task, indeed, but is necessary to design. This study has measured middle class by quintiles. Other studies have measured it by deciles. Some economists have measured with solid thresholds whereas others have preferred poverty lines. Although their results are oftentimes contradicting, the vast majority of them coincide on two parameters: 1) the global middle class is increasing at a fast speed and 2) the global middle class shows clear signs of vulnerability. In order to assess the evolution of the global middle class, it must be carried systematically with standardized criteria in order to carry cross-country comparisons. Data unavailability is a serious shortcoming that this present study and others have faced in their analysis of the economic performance of the middle class.

As a result, econometric methods lack fundamental data in order to provide more precise findings. This data, however, must be generated promptly in order to study the

middle classes in the near future with more scientific accuracy. The middle classes are not only defined by their relative and absolute income levels. They are also a socio-cultural phenomenon. Globalization, as discussed in the previous chapter, has standardized the conception of what being 'middle class' is as it is increasingly set by Western standards.

Facebook offers an unprecedented database. It is reasonable to argue that it is the largest human database that has ever existed. The social network and platform that accelerates globalization must also offer its answers. Economists could study patterns of consumption, social networks, political interests and affiliations, human capital accumulation, etc. These patterns could be standardized in order to set certain standards within countries, regions and continents. Although it might not fully depict and define 'middle class' per se, it could give the best socio-cultural approximation to the concept itself. It is time to use Facebook for most scientific purposes. This might not necessarily hamper privacy rights. Only numbers would be taken from the most reliable human database ever created.

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TABLES

Table A. Descriptive Statistics (1980-1994)

Variable	Maximum	Minimum	Mean	Median	St. Deviation	Number of Observations
GDP%	8.56	-13.98	0.21	0.23	2.72	136
LogGDP	4.65	1.70	3.22	3.25	0.65	136
LogGDP1975	4.56	1.70	3.28	3.29	0.68	136
MC	41.65	17.44	36.17	37.09	4.09	136
PAR	5.00	0.00	2.57	2.00	1.38	136
EDU	6.36	0.07	1.93	1.47	1.45	119
ToT	0.19	-0.14	0.00	-0.01	0.04	92
Rlaw	8.49	2.37	5.29	5.18	1.70	106

Table B. Descriptive Statistics (1995-2009)

Variable	Maximum	Minimum	Mean	Median	St. Deviation	Number of Observations
GDP%	10.75	-3.27	2.54	2.25	2.25	136
LogGDP	4.67	1.72	3.29	3.27	0.69	136
LogGDP1990	4.79	1.64	3.35	3.35	0.72	136
MC	41.51	17.40	36.02	36.70	3.74	136
PAR	5.00	0.00	3.51	3.63	1.13	136
EDU	7.36	0.13	2.75	2.41	1.72	119
ToT	0.10	-0.07	0.01	0.00	0.03	110
Rlaw	9.44	1.56	5.50	5.32	1.96	112

Table C - Model One - Correlation Matrix (1980-1994)

	GDP%	logGDP1975	MC	**PAR**	MC*PAR	EDU	TOT	RLAW
GDP%								
logGDP1975	0.15							
MC	0.26	0.35						
PAR	0.29	0.80	0.29					
MC*PAR	0.31	0.81	0.50	*0.97*				
EDU	0.33	0.77	0.45	0.73	0.78			
TOT	0.06	0.04	0.18	0.02	0.06	0.06		
RLAW	0.44	0.75	0.40	0.71	0.75	0.71	0.07	

Table D*	Late Industrialized Countries				Early Industrialized Countries			
Middle-Class Households In Late Industrialized Countries (%)	South Korea (1990)	Taiwan (1988)	Hong Kong (1991)	Singapore (1989)	United States (1990)	United Kingdom (1981)	Sweden (1990)	Japan (1990)
Old Middle Class (OMC)	34.7	33.7	13.5	18.0	9.0	12.0	8.0	15.4
Small Farmers	14.3	13.7	0.5	0.3	1.7	2.1	2.8	4.8
Urban Petty Bourgeoisie (UPB)	20.4	20.0	13.0	17.7	7.3	9.9	5.2	10.6
New Middle Class (NMC)	10.0	9.9	11.5	21.6	27.1	26.5	31.1	21.8
Ratio of OMC/NMC	3.47	3.40	1.17	0.83	0.33	0.45	0.26	0.71
Ratio of UPB/NMC	2.04	2.02	1.13	0.82	0.27	0.37	0.17	0.49

Sources: Population Censuses and labor force surveys of South Korea, Hong Kong, Singapore, United States, United

Kingdom, Sweden and Japan, as compiled by the International Labor Office (1990, 1991, 1992, 1993); census data for Taiwan

taken from Sen (1991)

*Derived on its entirety from Burris (1999)

Table 1	Real GDP Growth Rate ($USD 2005) TSLS Wheatsugar instrument								
	[1]	[2]	[3]	[4a]	[4b]	[5a]	[5b]	[6a]	[6b]
Intercept	0.38	-0.38	-66.08	-4.25	-3.45	7.82	9.22	-1.81	-0.18
	(9.07)	9.11	(160.69)	(18.08)	(17.38)	(8.57)	(8.97)	(9.20)	(10.35)
Log GDP 1975	-2.07***	-2.54***	-1.46	-2.28***	-1.97**	-3.06***	-3.04***	-2.03***	-1.84**
	(0.63)	(0.69)	(2.71)	(0.74)	(0.86)	(0.75)	(0.92)	(0.70)	(0.85)
Education	0.45	0.33	0.64	-0.20	-1.70	0.44	0.44	0.27	0.31
	(0.38)	(0.39)	(0.53)	(0.45)	(7.48)	(0.35)	(0.32)	(0.39)	(0.35)
ToT	0.30	-0.58	-4.28	-2.95	-0.13	0.48	0.64	-1.57	-0.91
	(8.19)	(8.22)	(17.01)	(8.49)	(0.38)	(7.74)	(7.62)	(7.77)	(7.31)
RLaw	0.81***	0.71***	0.97*	0.78***	0.89***	0.70***	0.71***	0.45*	0.49**
	(0.26)	(0.27)	(0.50)	(0.27)	(0.27)	(0.25)	(0.24)	(0.26)	(0.24)
Middle Class (MC)	0.07	0.11	1.81	0.24	0.21	-0.06	-0.10	0.13	0.08
	(0.27)	(0.27)	(4.22)	(0.47)	(0.45)	(0.24)	(0.24)	(0.27)	(0.29)
PAR		0.47	20.10	0.22		0.44		0.63**	
		(0.31)	(44.82)	(0.34)		(0.29)		(0.32)	
MC*PAR			-0.55		-0.01		0.01		0.01
			(1.25)		(0.01)		(0.01)		(0.01)
East Asia & the Pacific				2.01	1.71				
				(1.28)	(1.06)				
Eastern Europe and Central Asia				-0.40	-0.95				
				(1.35)	(1.46)				
Latin America & the Caribbean				0.13	-0.05				
				(2.19)	(1.96)				
Middle East and North Africa				0.25	-0.001				
				(1.10)	(-0.001)				
South Asia				0.35	0.37				
				(1.60)	(1.570				
Sub-Sahara Africa				-2.11	-2.67*				
				(2.10)	(1.58)				
Manufactures						1.01	1.01		
						(0.82)	(0.86)		
Primary products						-1.94***	-1.94***		
						(0.56)	(0.57)		
Oil Exporters						-0.02	-0.02		
						(1.37)	(1.51)		
Exporters of Services						0.23	0.23		
						(0.87)	(0.87)		
Transition Economies								0.36	0.18
								(1.79)	(2.08)
Trauma								-0.23	-0.32
								(0.65)	(0.69)
Repressive Regimes								6.62***	6.37***
								(2.08)	(2.20)
R2	0.27	0.29	-0.14	0.45	0.47	0.46	0.45	0.39	0.38
Adjust R2	0.22	0.22	-0.27	0.33	0.36	0.37	0.36	0.29	0.29
D.Watson	1.57	1.47	1.54	1.74	1.86	1.61	1.62	1.67	1.71
Observ.	71	71	71	71	71	71	71	71	71

*significant at 90% **significant at 95% ***significant at 99% (Standard error in parentheses)

Table 2	Real GDP Growth Rate ($USD 2005) TSLS Wheatsugar instrument							
	[1]	[2]	[3a]	[3b]	[4a]	[4b]	[5a]	[5b]
Intercept	0.19	-0.37	-1.53	-5.06	3.21	0.32	1.77	2.22
	(7.45)	(7.35)	(19.68)	(27.89)	(9.63)	(12.73)	(7.20)	(8.78)
Log GDP 1975	-0.53	-0.21	-0.42	-0.24	-0.45	-0.26	-0.24	-0.24
	(0.53)	(0.57)	(0.69)	(1.08)	(0.69)	(0.99)	(0.50)	(0.57)
Education	-0.13	-0.10	-0.19	-0.17	-0.16	-0.14	-0.10	-0.10
	(0.230	(0.23	(0.26)	(0.23)	(0.23)	(0.22)	(0.21)	(0.20)
ToT	3.00	0.32	3.33	2.23	10.19	10.24	3.52	3.47
	(7.17)	(7.42)	(7.49)	(8.90)	(8.98)	(8.83)	(6.53)	(7.09)
RLaw	0.24	0.23	0.40**	0.42**	0.26	0.24	0.13	0.13
	(0.27)	(0.27)	(0.20)	(0.20)	(0.33)	(0.36)	(0.25)	(0.23)
Middle Class (MC)	0.07	0.10	0.11	0.21	0.03	0.11	0.001	-0.01
	(0.24)	(0.24)	(0.53)	(0.75)	(0.29)	(0.38)	(0.23)	(0.29)
PAR		-0.37	-0.35		-0.41		0.11	
		(0.27)	(0.41)		(0.28)		(0.27)	
MC*PAR				-0.02		-0.02		0.003
				(0.03)		(0.02)		(0.01)
East Asia & the Pacific			0.97	0.94				
			(1.15)	(1.08)				
Eastern Europe and Central Asia			1.60	1.69				
			(1.16)	(1.23)				
Latin America & the Caribbean			1.11	1.39				
			(3.05)	(4.06)				
Middle East and North Africa			0.75	0.75				
			(0.93)	(0.97)				
South Asia			1.56	1.73				
			(1.78)	(2.29)				
Sub-Sahara Africa			-0.36	-0.15				
			(2.21)	(2.93)				
Manufactures					1.07	1.01		
					(0.86)	(0.98)		
Primary products					-0.88	-0.87		
					(0.69)	(0.70)		
Oil Exporters					-1.06	-1.35		
					(1.51)	(1.94)		
Exporters of Services					0.44	0.46		
					(0.65)	(0.65)		
Transition Economies							1.77	1.77
							(1.30)	(1.20)
Trauma							-1.64**	-1.64*
							(0.83)	(0.85)
Repressive Regimes							5.42***	5.42***
							(1.28)	(1.790
R2	0.06	0.08	0.22	0.22	0.17	0.18	0.34	0.34
Adjust R2	-0.01	0.01	0.07	0.07	0.04	0.06	0.26	0.25
D.Watson	1.67	1.69	1.87	1.85	1.78	1.8	1.74	1.75
Observations	78	78	78	78	78	78	78	78

*significant at 90% **significant at 95% ***significant at 99% (Standard error in parentheses)

Table 3	Logarithm of Real GDP Per capita ($USD 2005) TSLS Pop. Density 1500 instrument							
	[1]	[2]	[3a]	[3b]	[4a]	[4b]	[5a]	[5b]
Intercept	4.04***	3.67***	4.86***	4.61	3.53***	3.65***	3.45***	3.50***
	(1.01)	(1.12)	(1.71)	(1.44)	(0.87)	(0.71)	(1.11)	(0.86)
Education	0.29***	0.24***	0.20	0.14	0.23***	0.20***	0.23***	0.19**
	(0.07)	(0.09)	(0.09)	(0.09)	(0.07)	(0.06)	(0.08)	(0.07)
Terms of Trade	-0.91	-0.84	0.08	0.01	1.06	1.07	-0.81	-0.75
	(1.49)	(1.45)	(1.53)	(1.49)	(1.37)	(1.36)	(1.44)	(1.41)
Rule of Law	0.11**	0.11**	0.15**	0.13**	0.08**	0.08*	0.12**	0.12**
	(0.05)	(0.05)	(0.06)	(0.06)	(0.05)	(0.05)	(0.05)	(0.05)
Middle Class Share (MC)	-0.05*	-0.05	-0.07	-0.06*	-0.04	-0.04**	-0.04	-0.04*
	(0.03)	(0.03)	(0.04)	(0.04)	(0.02)	(0.02)	(0.03)	(0.03)
Political Competition (PAR)		0.07	-0.04		0.09		0.08	
		(0.07)	(0.09)		(0.06)		(0.07)	
MC*PAR				0.002		(0.003)**		0.004**
				(0.002)		(0.001)		(0.001)
East Asia & the Pacific			-0.18	-0.12				
			(0.40)	(0.39)				
Eastern Europe and Central Asia								
Latin America & the Caribbean			-0.15	-0.18				
			(0.45)	(0.45)				
Middle East and North Africa			-0.06	0.02				
			(0.50)	(0.49)				
South Asia			-0.38	-0.39				
			(0.51)	(0.50)				
Sub Sahara Africa			-0.65	-0.54				
			(0.51)	(0.47)				
Exporters of Manufactures					0.60**	0.60**		
					(0.29)	0.29		
Exporters of primary products					-0.11	-0.10		
					(0.11)	(0.11)		
Exporters of Oil					0.59***	0.60***		
					(0.19)	(0.19)		
Exporters of Services					0.11	0.11		
					(0.17)	(0.16)		
Transition Economies								
Trauma							0.08	0.10
							(0.13)	(0.13)
Repressive Regimes								
R-Squared	0.53	0.56	0.59	0.61	0.7	0.71	0.58	0.59
Adjust R-Squared	0.49	0.52	0.51	0.53	0.65	0.65	0.53	0.54
Durbin-Watson	1.53	1.44	1.52	1.52	2.22	2.17	1.44	1.44
N. Observations	58	58	58	58	58	58	58	58

*significant at 90% **significant at 95% ***significant at 99% (Standard error in parentheses)

Table 4	Logarithm of Real GDP Per capita ($USD 2005) TSLS Pop. Density 1500 instrument							
	[1]	[2]	[3a]	[3b]	[4a]	[4b]	[5a]	[5b]
Intercept	4.37***	3.94***	4.44*	4.52**	4.01***	3.93***	3.97***	3.76***
	(1.40)	(1.42)	(2.50)	(2.34)	(1.12	(0.89)	(1.42)	(1.04)
Education	0.33***	0.31***	0.18***	0.16**	0.26***	0.24***	0.31***	0.28***
	(0.05)	(0.05)	(0.06)	(0.07	(0.05)	(0.05)	(0.05)	(0.05)
Terms of Trade	3.64**	3.90**	4.21**	4.37***	2.75	2.95	3.80**	4.09**
	(1.67)	(1.64)	(1.62)	(1.62)	(1.88)	(1.81)	(1.66)	(1.62)
Rule of Law	0.09**	0.09**	0.09*	0.09*	0.08**	0.08**	0.08**	0.08**
	(0.04)	(0.04)	(0.05)	(0.05)	(0.04)	(0.03)	(0.04)	(0.04)
Middle Class Share (MC)	-0.07	-0.06	-0.06	-0.06	-0.06*	-0.06**	-0.06	-0.06
	(0.04)	(0.04)	(0.06)	(0.06)	(0.03)	(0.03)	(0.04)	(0.03)
Political Competition (PAR)		0.05	0.09		0.06		0.05	
		(0.06)	(0.07)		(0.05)		(0.06)	
MC*PAR				0.004		0.003*		0.003
				(0.003)		(0.002)		(0.002)
East Asia & the Pacific			-0.22	-0.12				
			(0.37)	(0.34)				
Eastern Europe and Central Asia								
Latin America & the Caribbean			-0.34	-0.31				
			(0.56)	(0.53)				
Middle East and North Africa			-0.29	-0.20				
			(0.40)	(0.38)				
South Asia			-0.61	-0.57				
			(0.46)	(0.43)				
Sub Sahara Africa			-0.74	-0.69				
			(0.52)	(0.48)				
Exporters of Manufactures					0.63**	0.63**		
					(0.30)	(0.29)		
Exporters of primary products					-0.24**	-0.22**		
					(0.12)	(0.11)		
Exporters of Oil					0.39	0.38		
					(0.24)	(0.23)		
Exporters of Services					-0.06	-0.06		
					(0.15)	(0.14)		
Transition Economies								
Trauma							-0.10	-0.10
							(0.18)	(0.17)
Repressive Regimes								
R-Squared	0.59	0.62	0.7	0.71	0.73	0.74	0.62	0.65
Adjust R-Squared	0.56	0.59	0.65	0.66	0.68	0.7	0.58	0.62
Durbin-Watson	1.76	1.61	1.41	1.28	1.78	1.71	1.6	1.43
N. Observations	65	65	65	65	65	65	65	65

*significant at 90% **significant at 95% ***significant at 99% (Standard error in parentheses)
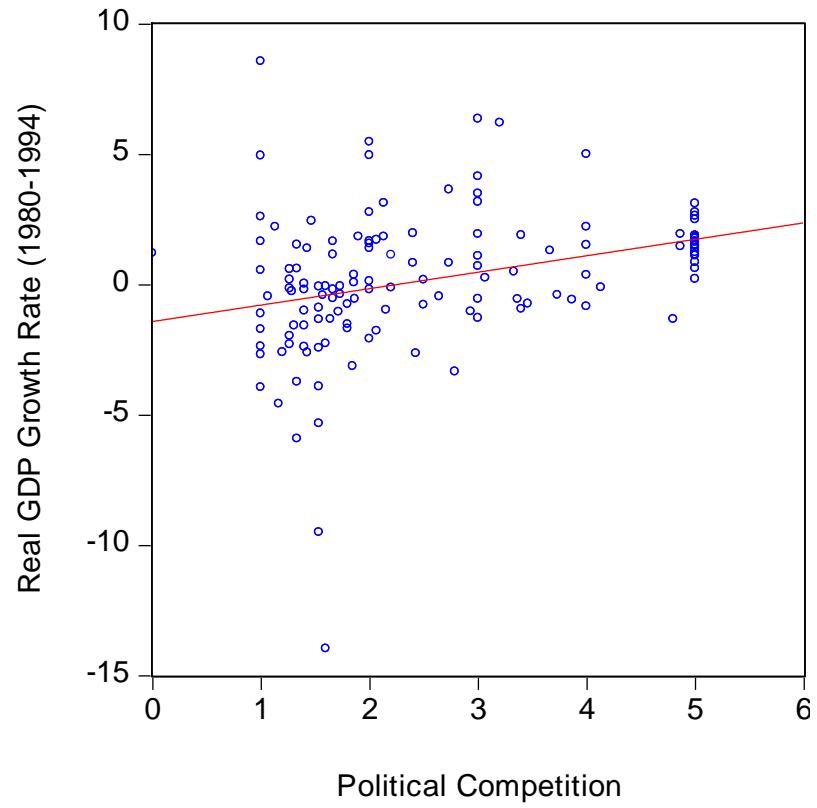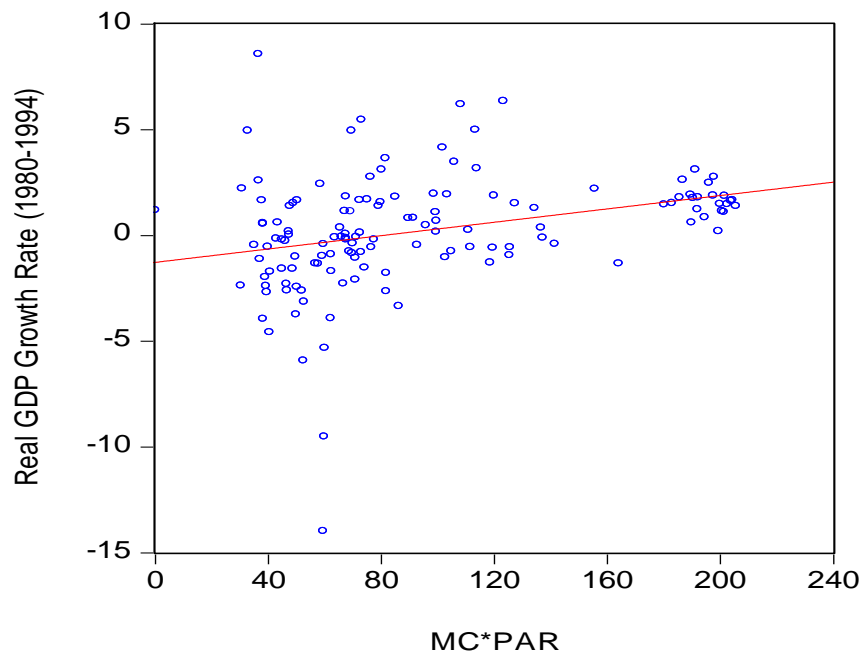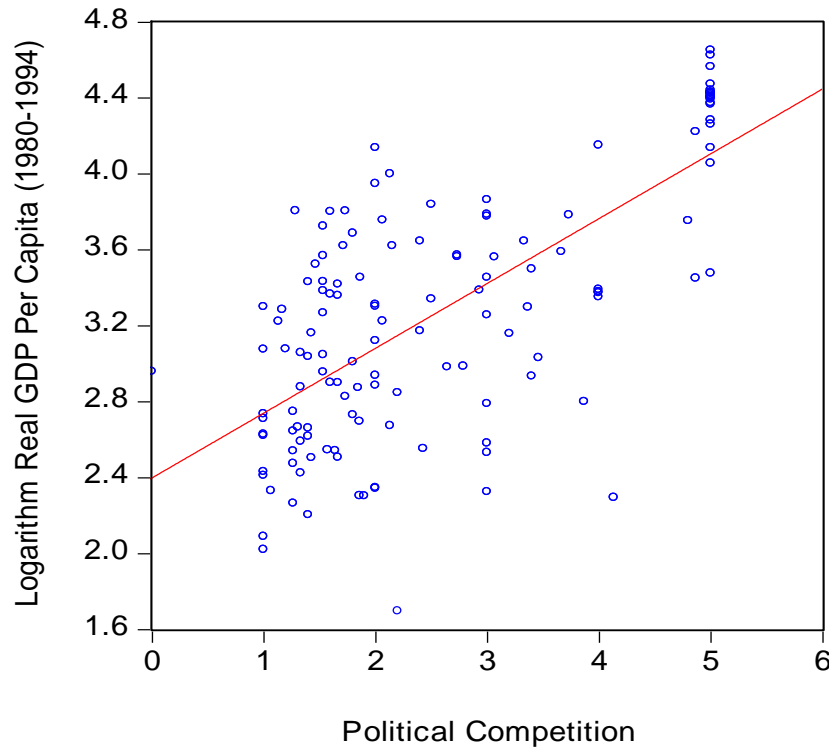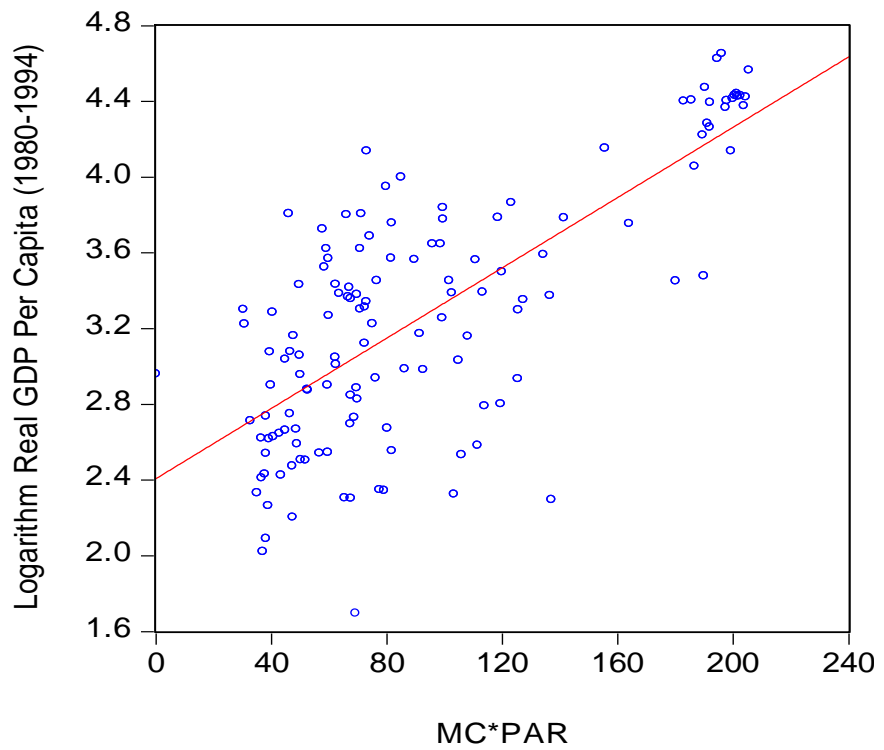
CHARTS

Chart 1

Chart 2

Chart 3

Chart 4

GRAPHS

Graph A

Recessionary impact of the Crisis on Latin America and the OECD

■ GDP growth in previous three years   ■ 2009 GDP growth
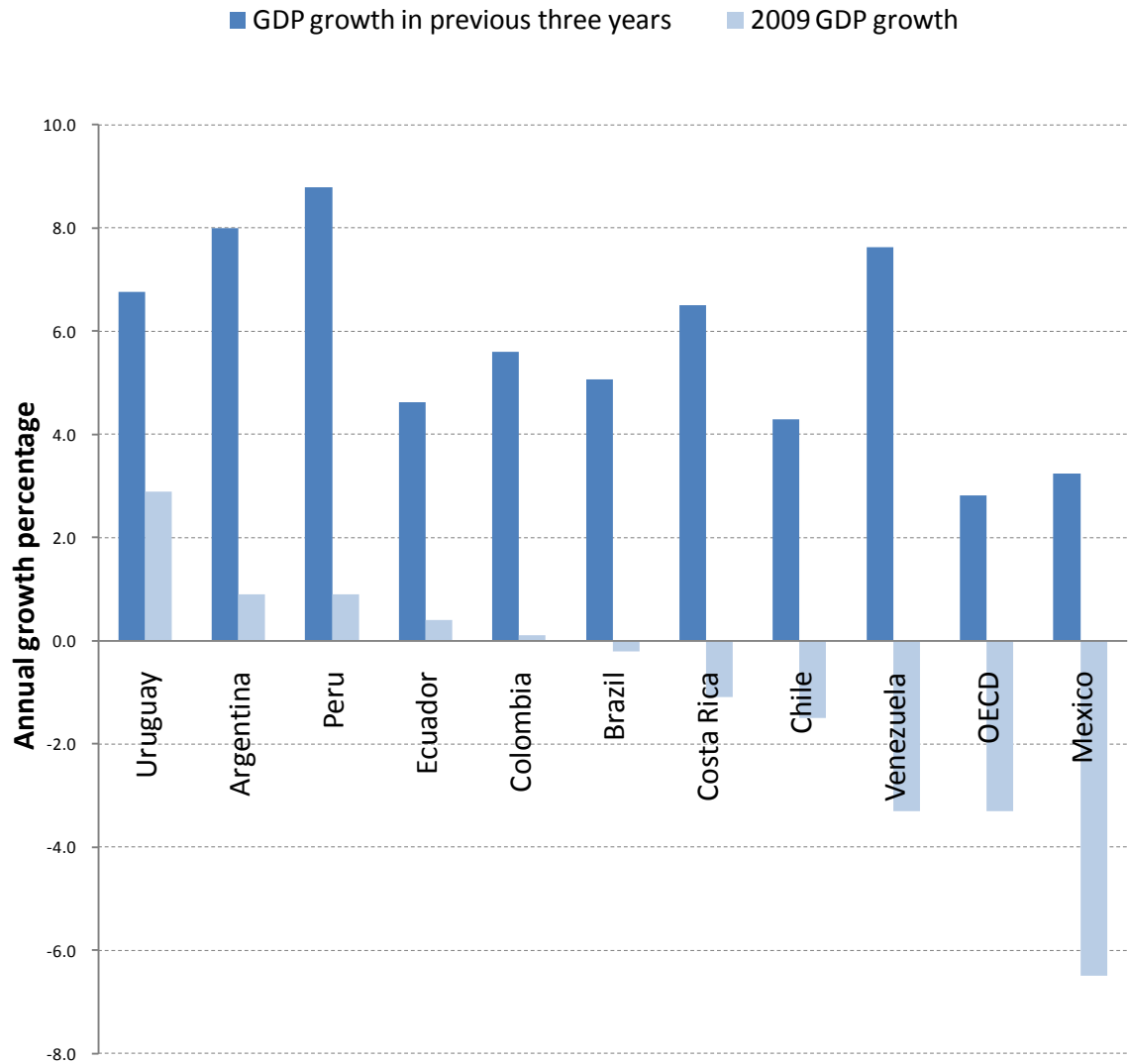
Source: OECD (2010)

Graph B.

Size of the Middle Sectors in Latin America And Italy
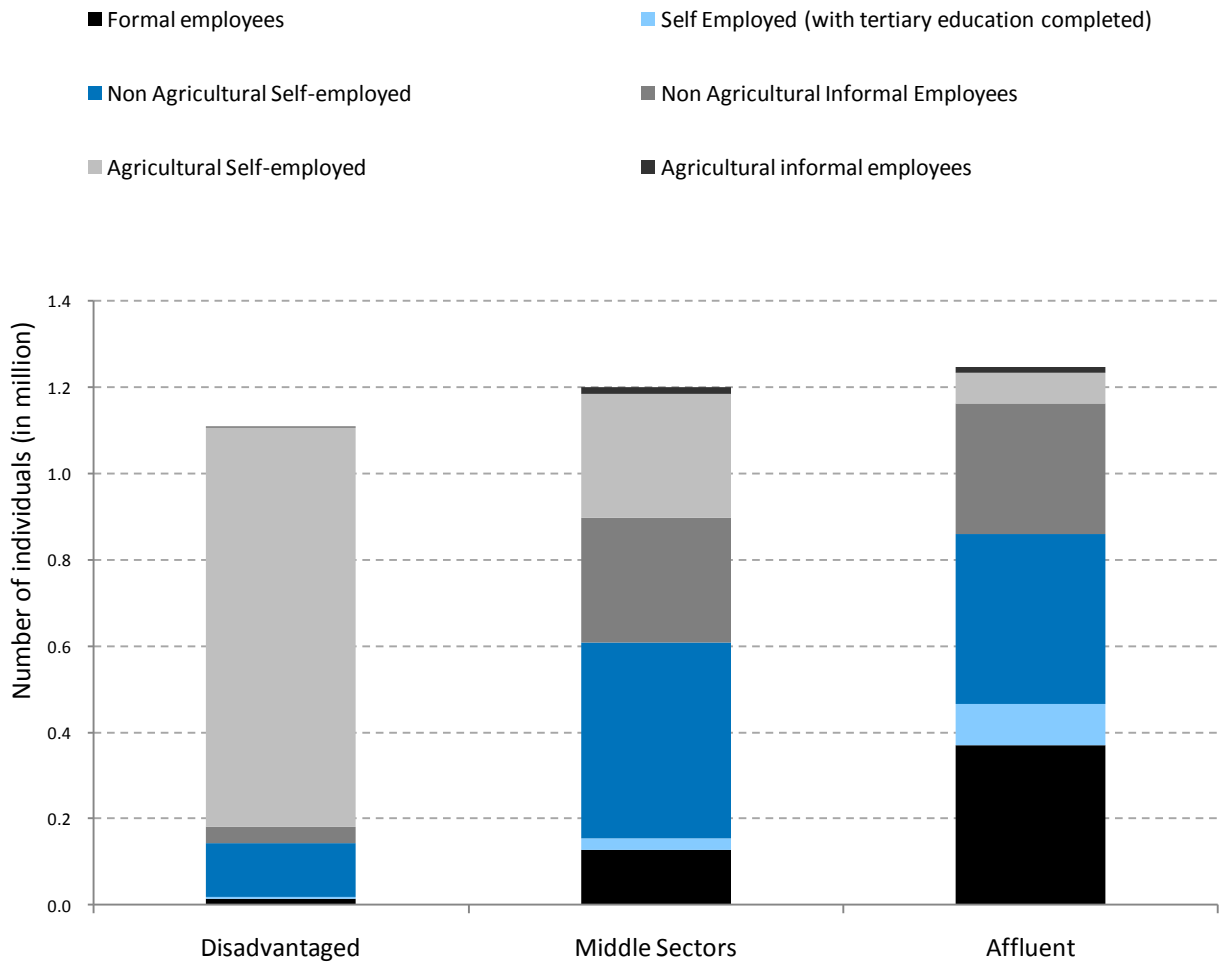*(as percentage of total households, 2006)**
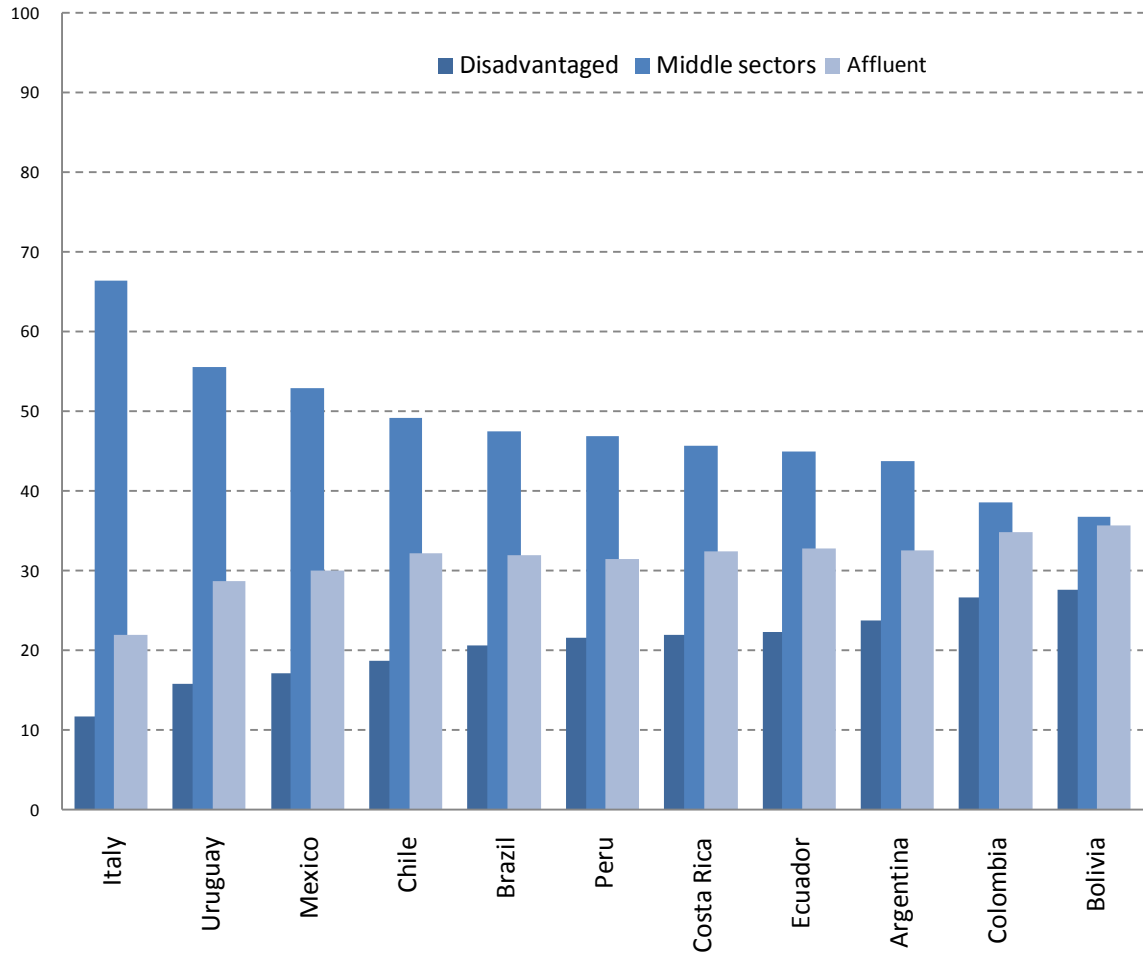
Source: OECD (2010)
Note: Data for Bolivia and Uruguay are for 2005, and Colombia from 2008. All estimates are based on households. A households is considered middle-sector if its income is between 50% and 150% of household median income
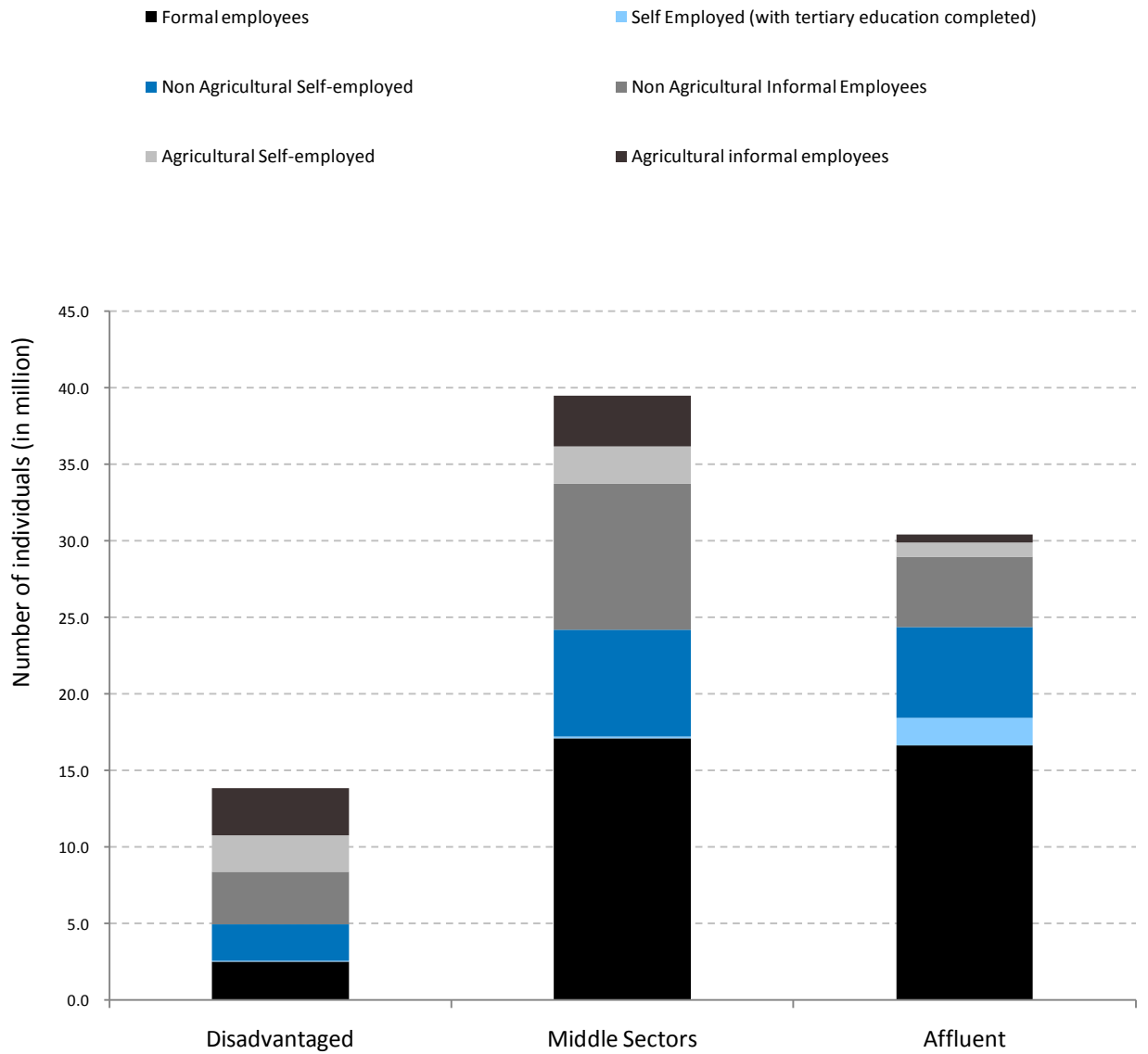
Graph C

Workers by Employment Category and Income Group

a) <u>Bolivia</u>

■ Formal employees   ■ Self Employed (with tertiary education completed)

■ Non Agricultural Self-employed   ■ Non Agricultural Informal Employees

■ Agricultural Self-employed   ■ Agricultural informal employees

Source: OECD (2010)

b) _Brazil_

Legend:
- ■ Formal employees
- ■ Self Employed (with tertiary education completed)
- ■ Non Agricultural Self-employed
- ■ Non Agricultural Informal Employees
- ■ Agricultural Self-employed
- ■ Agricultural informal employees

Source: OECD (2010)

c) <u>Chile</u>

■ Formal employees   ■ Self Employed (with tertiary education completed)

■ Non Agricultural Self-employed   ■ Non Agricultural Informal Employees

■ Agricultural Self-employed   ■ Agricultural informal employees

Source: OECD (2010)

d) <u>Mexico</u>

- ■ Formal employees
- ■ Self Employed (with tertiary education completed)
- ■ Non Agricultural Self-employed
- ■ Non Agricultural Informal Employees
- ■ Agricultural Self-employed
- ■ Agricultural informal employees
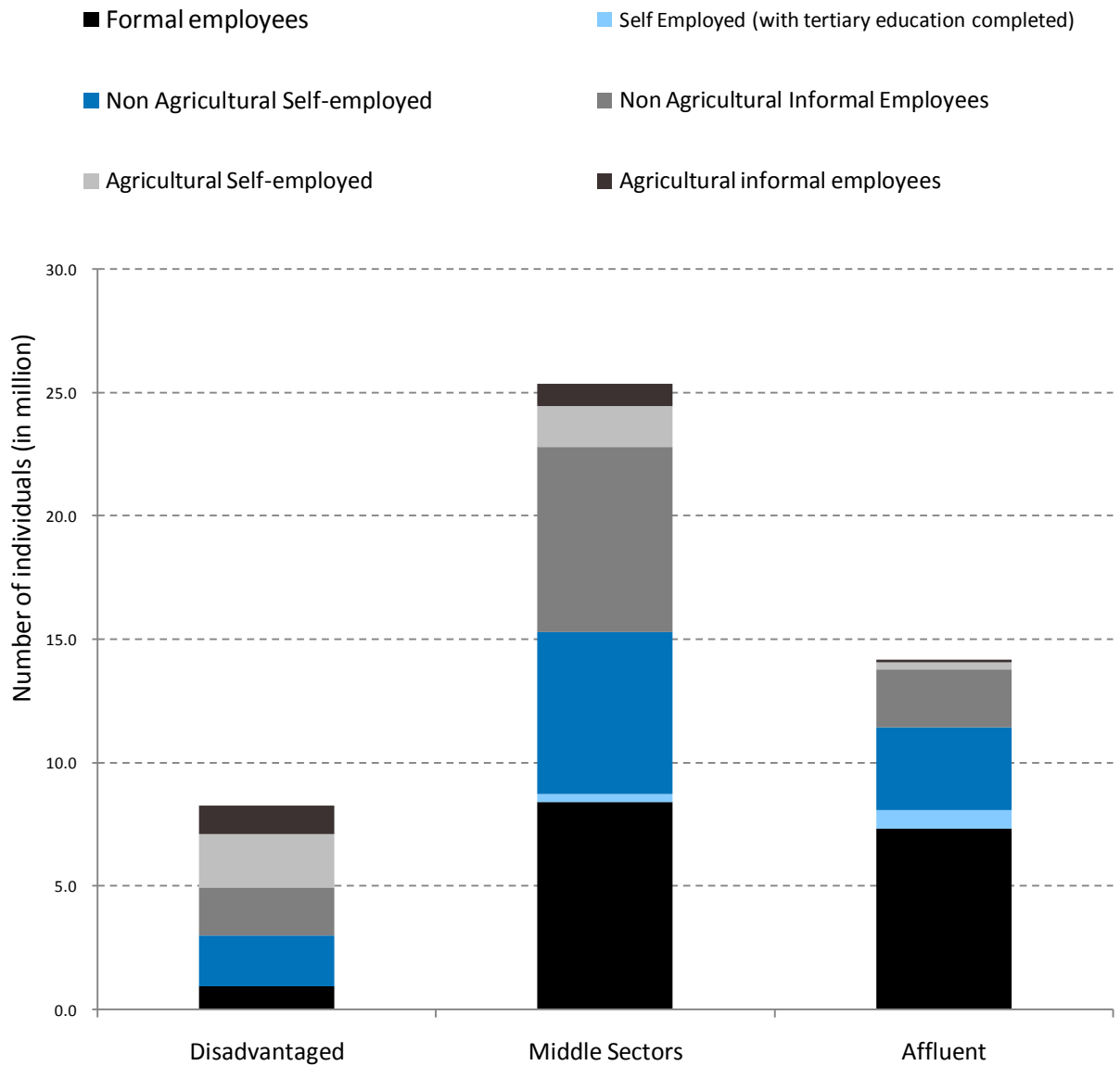
Graph D

Satisfaction with and Support for Democracy
(percentage of respondents, 2008)

■ Satisfaction with functioning of democracy   ■ Support of democratic systems
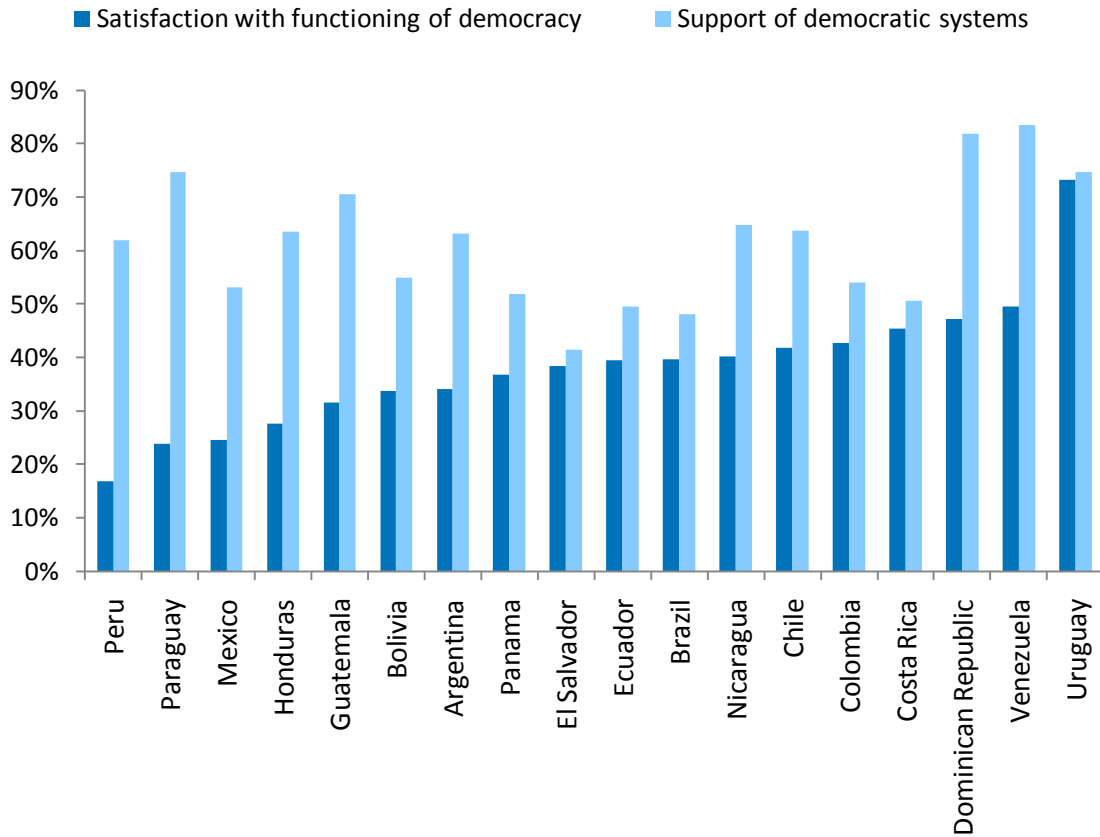
Source: OECD (2011)

Graph E

*Distribution of political preferences by perceived income quintiles
(Percentage of respondents)*
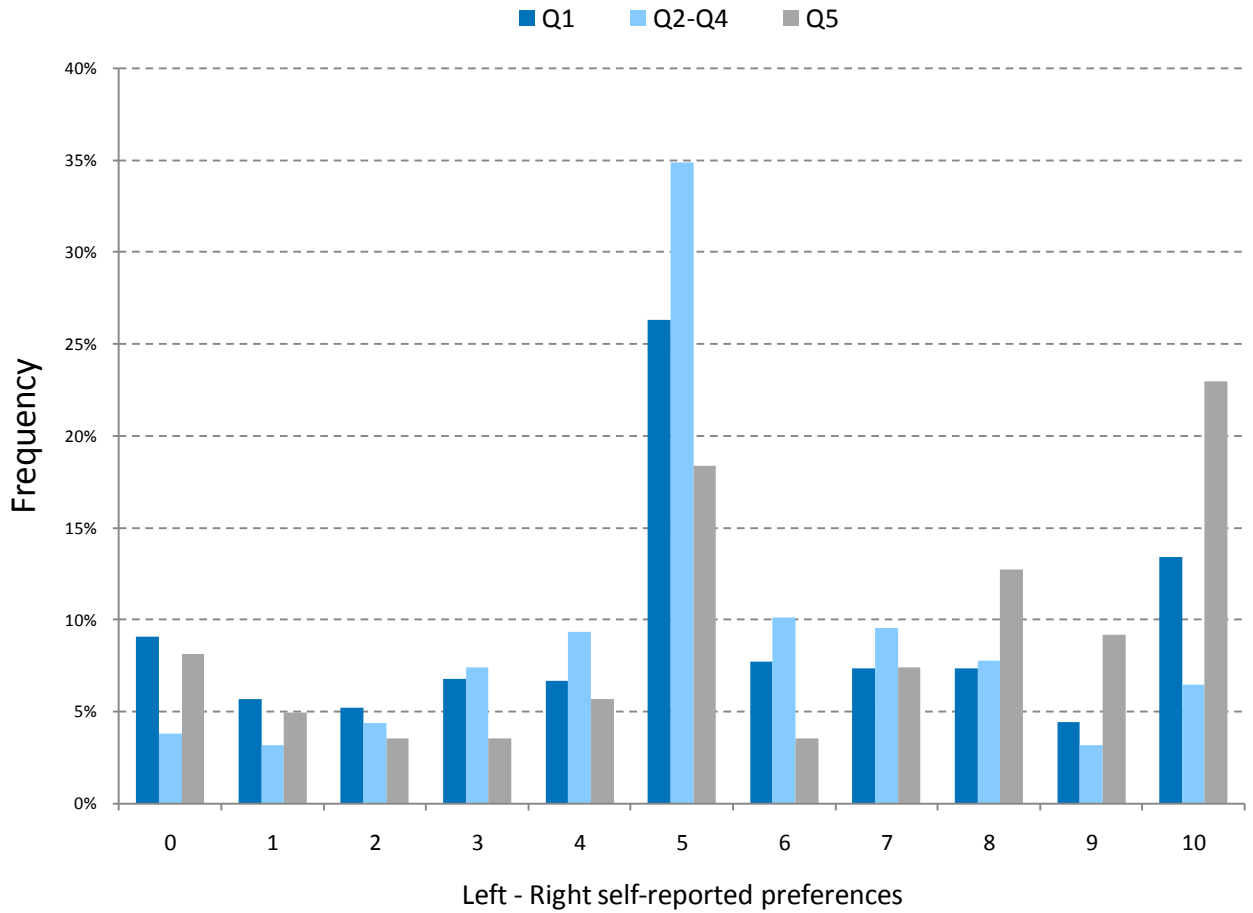
Note: Respondents classify themselves on a scale from 0 to 10, where 0 is the extreme
left and 10 is the extreme right

Source: OECD (2010)

APPENDIX I

DESCRIPTION OF POLITY IV PROJECT'S PARAMETERS

(Source: Polity IV's project website)

The Competitiveness of Participation: The competitiveness of participation refers to the extent to which alternative preferences for policy and leadership can be pursued in the political arena. *Political competition implies a significant degree of civil interaction*, so polities which are coded Unregulated (1) on Regulation of Participation (PARREG, variable 2.5) are not coded for competitiveness. Polities in transition between Unregulated and any of the regulated forms on variable 2.5 also are not coded on variable 2.6. Competitiveness is coded on a five category scale:

(0) Not Applicable: This is used for polities that are coded as Unregulated, or moving to/from that position, in Regulation of Political Participation (variable 2.6).

(1) Repressed: No significant oppositional activity is permitted outside the ranks of the regime and ruling party. Totalitarian party systems, authoritarian military dictatorships, and despotic monarchies are typically coded here. However, the mere existence of these structures is not sufficient for a Repressed coding. The regime's institutional structure must also be matched by its demonstrated ability to repress oppositional competition.

(2) Suppressed: Some organized, political competition occurs outside government, without serious factionalism; but the regime systematically and sharply limits its form, extent, or both in ways that exclude substantial groups (20% or more of the adult population) from participation. Suppressed competition is distinguished from Factional competition (below) by the systematic, persisting nature of the restrictions: large classes

of people, groups, or <u>types of peaceful political competition are continuously excluded</u> <u>from the political process.</u> As an operational rule, the banning of a political party which received more than 10% of the vote in a recent national election is sufficient evidence that competition is "suppressed." However, other information is required to determine whether the appropriate coding is (2) Suppressed or (3) Factional competition. This category is also used to characterize transitions between Factional and Repressed competition. Examples of "suppression" are:

i. *Prohibiting some kinds of political organizations*, either by type or group of people involved (e.g., no national political parties or no ethnic political organizations).

ii. Prohibiting some kinds of political action (e.g., Communist parties may organize but are prohibited from competing in elections).

iii. Systematic harassment of political opposition (leaders killed, jailed, or sent into exile; candidates regularly ruled off ballots; opposition media banned, etc.). This is evidence for either Factional, Suppressed, or Repressed, depending on the nature of the regime, the opposition, and the persistence of political groups.

Note 3.6: A newly enacted right to engage in political activities is most likely a change from category 1 to 2.

(3) Factional: Polities with parochial or ethnic-based political factions that regularly compete <u>for political influence in order to promote particularist agendas and favor group</u> <u>members to the detriment of common, secular, or cross-cutting agendas.</u>

(4) Transitional: Any transitional arrangement from Restricted or Factional patterns to fully Competitive patterns, or vice versa. Transitional arrangements are accommodative

of competing, parochial <u>interests but have not fully linked parochial with broader</u>, general interests. ***<u>Sectarian and secular interest groups coexist.</u>***

(5) Competitive: There are relatively stable and enduring, secular political groups which regularly compete for political influence at the national level; ruling groups and coalitions regularly, voluntarily transfer central power to competing groups. Competition among groups seldom involves coercion or disruption. Small parties or political groups may be restricted in the Competitive pattern.