

# Paper 2

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Hector Bahamonde, December 2016

## New Framing

Originally, this paper sought to find the *origins* of industrial development. The plan was to use the *dual sector* model to explain under what conditions strong industrial emerge. I think the paper would have been *too* descriptive, *too* of an "economic" paper.

Instead, the new framing explains both economic and political development. It does so by incorporating sectoral conflict, and how the conflict was rooted in the economic structural transformation that took place around the 1900s. The sectoral competition is the same one **described** in *Paper 1*. However, in *Paper 2* I **explain** the **mechanics** of this conflict using the *dual sector* model.

## Theory

*Paper 1* argues that sectoral conflict caused the imposition of the income tax. The second part of the argument (which I left empirically untested) is that the income tax was a *state-building institution*, that is, an institution that *triggered* other "state-institutions." In *Paper 2* I take care of this untested proposition and **argue** that the income tax, as a political institution that was product of an inter-sectoral conflict, helped countries to develop institutions that promoted both economic and political development.

**Mechanics of the argument.** Building on the dual-sector economy model, I argue that the **directionality** of economic development

indicates whether the elite structure received from the colonial period was (1) **preserved** or (2) **reversed**. When the status-quo was challenged, both economic and political development happened. To make sure, what is *challenged/reversed* is the initial situation in which the rural landowners are the primary economic sector and most powerful elite. When industrialist newcomers grew **at the expenses** of the historically dominant class, that is, when the directionality of economic development goes from agriculture to industry, **the selectorate expanded, necessarily reducing the power of the historically dominant class** (i.e. landowners). However, when industrial newcomers helped growing the traditionally dominant class, the selectorate was not expanded, and the dominant class continued being hegemonic. In sum, the **direction** in which **economic development** happens alters the sectoral relative endowments of **political power**. The selectorate is important as it permits the legitimated use of state power. I explained in *Paper 1* that there were incentives to centralize state power when sectoral sizes were of about the same size. In *Paper 2* the same logic applies: when the status-quo is challenged (which requires similar sectoral sizes), economic and political development happen.

The dual-sector model strongly agrees that when the industrial sector grows at the expenses of the agricultural sector, countries develop. Building on this idea, I claim that while this path causes **economic** development, it necessarily alters the **political** (and **military**) power between the two elites. Contrasting the modernization theory with my approach, while the former argues that rising incomes favored the emergence of democratic values, my approach says that economic and political development happen together because the economy alters the way in which elites are politically structured.

Continuing with the mechanics of the argument, an important point (that

was left out of *Paper 1*) is that *all* countries, *eventually*, implemented the income tax. *Paper 1* does suggest that sectoral conflicts *accelerate* **political development, in the form of the implementation of the income tax law**. However, it is not clear whether political development actually caused economic development (as *Paper 1* promises).

Institutional economists argue that political development should set the basis for economic development. However, the inter-sectoral distinction has been absent from this debate. In this paper I argue that, though all countries eventually implemented the income tax law, when its implementation reflected an inter-sectoral conflict, this institution set the basis for **economic development**. In other words, I seek to explain *economic development* as a function of *political development*.

## **Empirics**

I use several time-series methodologies to make my point. My results confirm the theory.