

The role of democracy in economic growth : a (brief) literature review

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Abstract:

This article presents a brief review of recent work by economists studying the effects of democracy on economic growth. These studies are divided into three groups: the first one supports the general view that democracy has a positive effect on economic growth; democratic regimes increase the level of GDP by creating the climate of trust, guaranteeing the protection of property rights, as well as reducing transaction costs, while dictatorship regimes strongly hinder economic growth. The second group of researchers stipulated that non-democratic regimes would be more favorable to increasing economic growth. For the third research group, there is no significant relationship between the two variables.

The common point of these studies, despite the absence of a consensus, is their insistence that the political regime matters for economic growth and development.

Keywords: *Economic growth - Democracy - Institutions*

Introduction

The question of the role of institutions in determining economic performance has re-emerged over the last three decades, both among economists and experts from international institutions. It is now commonly accepted that institutions matter (Kaufmann et al, 1999), or even that they rule (Rodrik et al, 2004). Thus, institutions have become a major object of study in macro-economics of development, particularly from a neo-institutionalist perspective [North, Greif, Kaufmann, Rodrik ...]¹.

The debate on the nature of the relationship between democracy and economic growth has also been a major concern for researchers since the end of the Second World War, with the publication of **Seymour Martin Lipset**'s famous article², which succeeded in establishing a linear relationship between democracy and socioeconomic development (literacy - urbanization - increase in gross national product, etc.) and argue that: *"The richer a country is, the more likely it is to experience sustainable democracy"*. Also, other authors have addressed the issue in both its theoretical and empirical aspects. The results of these studies, both theoretical and empirical, remain very ambiguous on the existence of a relationship and the direction of causality and do not lead to a consensus. While some authors such as (**Rodrik, 1997 ; Acemoglu et al, 2014 ; Barro, 1996**) have shown a significant positive impact of democracy on growth, others contradict this impact.

Therefore, the question is whether democracy has or not an effect on economic growth. Thus, the purpose of this article is to highlight the link between democracy as an institution and economic growth. To do this, we conducted a literature review of articles, publications, and journals related to this field, and in particular to the New Institutional Economics (NIE) field. The aim was to emphasize the role of democratization in the development of nations and to clarify the channels of such a process. The problem addressed in our research paper is the following: What is the role of democracy in economic growth? In order to discuss the problem,

¹ See for example : Rodrik, D., Subramanian, A., & Trebbi, F. (2004). Institutions Rule : The Primacy of Institutions Over Geography and Integration in Economic Development. *Journal of Economic Growth*, 9(2), 131-165. <https://doi.org/10.1023/b:joeg.0000031425.72248.85>

² Lipset, S. M. (1959). Some Social Requisites of Democracy: Economic Development and Political Legitimacy. *The American Political Science Review*, 53(1), 69-105. <https://doi.org/10.2307/1951731>

we first clarify the concept of democracy and its measurement, before presenting the main results of the empirical literature on the subject.

The objective is contributing to relaunch the debate on this issue to help better guide institutional reforms. Such an understanding of this process would provide a better understanding of the failures of the different growth strategies pursued by several Third World countries and would help to better guide future economic policies.

1) What is democracy?

The term democracy is the most commonly used word in political science. It has been the subject of many polysemic, less precise, and sometimes contradictory definitions. It is a multifaceted concept.

The word etymology derives from the Greek word *Demokratia*, which combines two shorter words; *Demos* meaning people, and *Kratos* meaning power. Democracy as a political regime is distinct from the monarchy, aristocracy, and dictatorship. According to President **Abraham Lincoln**'s famous definition, democracy is: "the government of the people, by the people, for the people".

In a narrow definition given by **Seymour Lipset (1959)**³ : *" Democracy (in a complex society) is defined as a political system which supplies regular constitutional opportunities for changing the governing officials. It is a social mechanism for the resolution of the problem of societal decision-making among conflicting interest groups which permits the largest possible part of the population to influence these decisions through their ability to choose among alternative contenders for political office. "* (Seymour Lipset, 1959, P71).

Joseph Schumpeter (1942) defined democracy as: *"That institutional arrangement for arriving at political decisions in which individuals acquire the power to decide to employ a competitive struggle for the people's vote. "*⁴

In another definition given by **Huntington (1991)**: "The central procedure of democracy is the selection of leaders through competitive elections by the people they govern."⁵

³ Lipset, S. M. (1959). Some Social Requisites of Democracy: Economic Development and Political Legitimacy. *The American Political Science Review*, 53(1), 69–105. <https://doi.org/10.2307/1951731>

⁴ O'Donnell, G. A. (2002). *Democracy, Law, and Comparative Politics*. UC Berkeley: Center for the Study of Law and Society Jurisprudence and Social Policy Program. Retrieved from <https://escholarship.org/uc/item/5dc3886r>

⁵ Marie Lechler. *"Econometrical analysis of the interdependencies between the demographic transition and democracy"*. Anchor Academic Publishin, 2014. P.6.

Tavares and Wacziarg (2001, P. 1342): define democracy in purely *procedural* terms, "*as a body of rules and procedures that regulates the transfer of political power and the free expression of disagreement at all levels of public life*".⁶

From all these definitions, we can define democracy as a representative political system, in which sovereignty emanates from the people. It is the people who choose their representatives through free elections. However, democracy is not limited to the vote, it must be understood more in terms of civil and political rights, social justice, and equality.

2) The measure of democracy:

With the emergence of the New Institutional Economics, the concern to quantify qualitative institutional variables has become a necessity. Since then, several rating agencies have emerged, creating a wide variety of institutional indicators such as the Transparency International Corruption Perception Index (CPI), the Freedom House Political Index, etc.

Concerning democracy, its main measure is the indicator of electoral rights compiled by **Gastil (1982)**⁷ and published by Freedom House. This indicator measures political rights and civil liberties. It can be between 1 and 7. At level 1 the country is a total democracy, at level 7 the country is an autocratic regime establishing severe repression on the population.

Global Democracy Rating measures the quality of democracy of all democracies (country-based democracies) in the world. The Democracy Ranking publishes the ranking scores and displays ranking score increases or decreases over time. According to the organization, Norway leads, followed by Switzerland and Sweden, while France ranks 15th. Among the 30 most democratic countries in the world according to Democracy rating, 26 are members of the OECD.

3) The role of democracy in economic growth

The debate on the effect of democracy on development in general and economic growth, in particular, has been a major concern for researchers since the end of the Second World War and has become a major focus on the development of the New Institutional Economy. The results

⁶ Tavares, J., & Wacziarg, R. (2001b). How democracy affects growth. *European Economic Review*, 45(8), 1341-1378. [https://doi.org/10.1016/s0014-2921\(00\)00093-3](https://doi.org/10.1016/s0014-2921(00)00093-3)

⁷ "Political rights are rights to participate meaningfully in the political process. In a democracy this means the right of all adults to vote and compete for public office, and for elected representatives to have a decisive vote on public policy" (Gastil, 1986- 1987 edition, p 7).

of these studies remain very ambiguous both on the existence of a correlation and on the direction of causalities and do not lead to a consensus. While some researchers have shown that democratic countries grow faster than non-democratic countries, others refute this postulate or do not admit any significant relationship difference between democratic and authoritarian regimes.

a) Arguments in favor of democracy:

In a study by (Rodrik, 1997)⁸ using a sample of about 90 countries, the author finds that a democratic regime has at least four advantages in terms of economic growth over an authoritarian or non-democratic regime. First, it notes that there is no significant and determined relationship between GDP growth (over the period 1970-89) and democracy in the long term. He finds that the slope of the regression line linking democracy and growth is practically zero. But there is a flagrant superiority of democracy and this lies in its ability to generate greater stability of growth, which leads the author to say that " *living under an authoritarian regime is a much riskier gamble than living under a democracy* " ⁹.

Second, it shows that democracy has a positive impact on growth volatility and that democratic regimes are more resilient to economic shocks and crises before concluding that democratic institutions tend to be employment-friendly in that they allow higher wages and a high proportion of labor input.

In another study, Clague et al. (1996)¹⁰ analyzed the effect of democracy on property rights and contracts. They have shown that democracies better protect property rights and contracts, which is essential to attract investment and promote economic growth, and that democracy is important for growth and development than autocracy. But it takes time to be well consolidated politically and socially. However, in the very short term, emerging democracies cannot guarantee the protection of property and contract rights, especially if the country has just moved from an autocratic regime to democracy.

⁸ Rodrik, Dani. 1997. 'Democracy And Economic Performance.' Harvard University. <https://j.mp/2pdUVVV>.

⁹ Ibid, P,5

¹⁰ Clague, C., Keefer, P., Knack, S., & Olson, M. (1996). Property and Contract Rights in Autocracies and Democracies. Journal of Economic Growth, 1(2), 243-276. <https://mpira.ub.uni-muenchen.de/25720/>

In another pioneering study by **Robert J. Barro (1996)**¹¹ entitled "Democracy and growth". The author analyses the effect of democracy as measured by the index of political freedom on a panel of about 100 countries over the period 1960-1990 and shows that the relationship between the two is non-linear and that democracy has a positive impact on growth at low levels of democracy. It notes that at low levels of political freedom (democracy), an increase in political rights could strengthen economic growth by imposing limits on government, but beyond an average level of democracy, further increases in political rights could delay growth due to growing concerns about income redistribution.

In a recent study, **Acemoglu et al (2014)**¹², observed 175 countries between 1960 and 2010, they showed that democracy stimulates economic growth, indeed the transition from authoritarian to democratic regime increases GDP by 20% per capita over the next three decades.

Several other researchers have shown a direct or indirect positive and significant effect of democracy on growth: (Rodrik and Wacziarg (2005); Papaioannou and Siourounis (2008), Persson and Tabellini (2009); Kormendi and Meguire (1985) and Scully (1988)), etc.

b) Absence of the relationship:

In contrast to these studies, other researchers have shown that there is no significant effect of democracy on growth, as shown by **Perotti (1994)**¹³ in a cross-sectional study of 67 countries over the period 1960-1985 analyzing the effect of democracy through civil and economic freedoms, they concluded that democracy has no significant either positive or negative effect on growth. They also argue that there are differences in economic performance within non-democratic countries, pointing out that the economic performance of these countries is close to that of democratic countries. Also, **Alesina and Rodrik (1994)**¹⁴ showed that multiparty politics favoring clientelism results in redistribution requests.

¹¹Barro, R. (1996). Democracy and Growth. Journal of Economic Growth, 1(1), 1-27. <http://faculty.nps.edu/relooney/BarroDemocracy.pdf>

¹² Acemoglu, D., Naidu, S., Restrepo, P., & Robinson, J. A. (2014). Democracy Does Cause Growth. SSRN Electronic Journal. Published. <https://doi.org/10.2139/ssrn.2411791>

¹³ Perotti, R. (1996). Growth, income distribution, and democracy : What the data say. Journal of Economic Growth, 1(2), 149-187. <https://doi.org/10.1007/bf00138861>

¹⁴ Alesina, A., & Rodrik, D. (1994). Distributive Politics and Economic Growth. *The Quarterly Journal of Economics*, 109(2), 465–490. <https://doi.org/10.2307/2118470>

c) Arguments in favor of autocracy:

As mentioned at the beginning of this article, there is no consensus among economists and sociologists on the nature of the democracy-growth relationship in the empirical and theoretical literature. The debate remains highly controversial, especially since the historical experiences of some countries do not allow us to decide. Although most of the countries with the highest growth rates in the world are democratic countries, and those with authoritarian regimes are mostly the poorest, there are exceptions in both cases, such as the example of South Asian countries and particularly China, which is becoming the world's leading economic power, with a global economy, with a very high growth rate and an autocratic regime, as **Timothy Besley** and **Masayuki Kudamatsu (2007)** showed in their famous article "Making Autocracy Work"¹⁵ " which gives us a more different idea of autocratic regimes based on the Chinese example. For the authors, China's stable autocratic regime was the basis of its economic and human development. In the same vein, it should be recalled that the British Industrial Revolution took place before elections and democracy were established.

Other empirical work on the relationship between democracy and economic growth has been grouped in the following table:

¹⁵ Besley, Timothy and Kudamatsu, Masayuki, (2007), Making Autocracy Work, STICERD - Development Economics Papers - From 2008 this series has been superseded by Economic Organisation and Public Policy Discussion Papers, Suntory and Toyota International Centres for Economics and Related Disciplines, LSE, <https://EconPapers.repec.org/RePEc:cep:stidep:48>.

Table: Tabular overview of Empirical work on the relationship between Democracy and economic growth

Authors	Published year	Sample size	simple period	Statistic method	conclusion
Kurzman Werum & E. Burkhart	2002	106 countries	1951-1980	Pooled Time Series analysis	- No direct effect - Positive indirect effect
Democracy does not significantly hinder economic growth, but it has a positive indirect effect on it through investment and government spending.					
Helliwell	1994	125 countries	1960-1985	Cross-section	- Nonsignificant negative effect
Democracy does not significantly hinder economic growth, but it has a positive indirect effect on it through education and investment					
Tavares& Wacziarg	2001	65	1970-1989	Panel analysis	Negative effect
-Democracy stimulates growth by promoting human capital accumulation and reducing income inequality. - Democracy hinders growth by reducing the rate of physical capital accumulation.					
Levine & Renelt	1992	83 countries	1974-1989	Ordinary Least Squares	No robust effect
Aghion, Alesina, & Trebbi	2007	180	1963-2003	Panel analysis	Positive impact
Papaioannou & Gregorios Siourounis	2008	166 countries	1960-2003	Panel analysis	Positive effect
- Democratization stimulates real annual per capita by about 1% - During transition, growth slows significantly, and it stabilizes at a higher rate.					

Source : Done by the author through several different sources

Limitations and Future Research

The first important point to emphasize here, as a concluding remark, is that the empirical literature studying the effects of democracy on economic growth is characterized by a great diversity of approaches and methods of analysis. This diversity of approaches raises some doubts about the scientific validity of this corpus of studies. Moreover, as changes in political regimes may be correlated with other factors or with socio-economic conditions, studies using panel data may be subject to omitted variable bias.

Furthermore, this paper examines the influence of democracy on economic growth, however, the literature on institutions in relation to economic growth and development has examined this relationship in the opposite direction as well, which means that increasing economic growth and the level of development, in general, can also lead to democratization. Thus, it is very interesting to explore this relationship in the opposite direction, namely that, the relation which goes from economic growth to democracy.

Conclusion:

The interest in institutions has been growing significantly in recent years, both in the academic community and among development experts. However, a consensus is far from being reached among analysts on how and by which way institutions impact economic performance.

The purpose of this paper was to explore whether or not democracy as an institution influences economic growth through recent developments in the economic literature. This question has been addressed in different ways in parallel with the evolution of the work of the New Institutional Economics (NIE) stream. A large wave of studies argues that democracy is important or even vital for economic growth, while other studies have evolved in the opposite direction, showing that although democracy may offer the best chance of success for developing countries, it is not necessary for a successful country, as shown by the Chinese model.

Despite these differences between the various studies presented in this article, they all claim that whatever their nature, political regimes have a preminent impact on economic growth.

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