The relationship between political democracy and economic growth economics essay

The relationship between political democracy and economic growth has been a center of debate in the past fifty years. A corpus of cross-country research has shown that the theoretical divide on the impact of democratic versus authoritarian regimes on growth is matched by ambiguous empirical results, resulting in a consensus of an inconclusive relationship. Through this paper challenges this consensus. In contrast to the current consensus, we show that once the microscope of analysis is applied to the accumulated evidence, it is possible to draw several firm and robust conclusions regarding democracy and economic growth.

Supporter of democracy argue that the motivations of citizens to work and invest, the effective allocation of resources in the marketplace, and profit maximizing private activity can all be maintained in a climate of liberty, free-flowing information and secured control of property (North, 1990). Democracies can limit state intervention in the economy, are responsive to public's demands on area such as education, justice and health, and encourage stable and long run growth (Rodrik, 1999, Lake and Baum 2001, Baum and Lake 2003). Opponents of democracy, on the other hand, argue that democracies lend themselves to popular demand for immediate consumption at the expense of profitable investments, cannot be insulated from the interest of rent-seekers, and cannot mobilize resource swiftly. Democracies are said also to be prone to conflicts due to social, ethnic and class struggles. While some authors favor authoritarian regime to suppress conflicts, resist sectional interests and take coercive measures necessary for rapid growth, others remain overall skeptical on whether regimes, rather than markets and institutions, matter for growth (Bhagwati 1995).

Actually, there are millions of journal articles on the internet regarding to the topic of democracy and economic growth, and in order to get those articles, Google scholars and others journal websites are used to download those to read. Moreover, I use the snowball technic to keep on trace of the best sources. For example, when I found the best source, I look at its references, and then I followed the old references or foot notes of each best source to get more best sources. Since some journals are not free for download, I somehow need to spend money on the journal website in order to get the sources. Moreover, in term of getting best sources from the Google or Google scholar, I typed the only the key words of the topic of research. For instance, instead of using economic growth, I can use economic development, or Gross nation products of each nation. What is more, in order to limit the number of sources on the net, I used the quotation mark, plus sign, or equal sing around the word finding. Importantly, even there are a lot of website that can provide the best convincing information regarding to the topic, I still looked and priority on the famous websites before selecting the sources.

Meanwhile of the finding and selecting the best sources, I scanned all the sources to get the overall ideas-what those resources mean to the readers, and in specific skill of selecting the best sources, I just looked the abstract part, and jumped to the conclusion. By doing that, I can pretty sure that I can comprehend what the papers want to be told. Then, I look at those finding, methodologies, limitation, and discussion sections to analyze, find the strength and weakness, and to critic them in the right ways. Of course, even the general knowledge of the researchers seem to be so higher than me, and in order to critic them, I need to read what the fallacy of the research are. For example, some researchers might give their own judgments which cannot be applied in some extend, and some analyzed only in the present by ignoring the past.

Beside this, in order to produce this paper, first of all, I need to do a lot of extensive reading on the found sources to select the best source. During the reading, I also quoted regarding to the theme which I was prepared on the time of literature reviewing. Once I had done all the reading, I started to type all the important information to each belonging theme or coding, then I read those information which came from many different scholars to get the common sense of idea on one particular point, so by doing it back and forth with a serious attention, Finally, I can produce this research paper which can summary all the main ideas of the existed sources.

Therefore, this paper presents an analysis on the democracy-growth relationship, based on 10 published studies. It is an important step to addressing the deadlock on the democracy growth relationship. The literature need such as urgent comprehensive assessment on the issue in the wake of massive democratizations for many developing countries. Reviews of this literature and many authors who have contributed to it, state that the association is inconclusive. Faced with a diverse set of conflicting results, they are unable to conclude whether the association is positive, negative or non-existent. We find that once all the available evidence is considered, holding research design differences constant, the evidence does not point to democracy having a detrimental impact on growth. Moreover, this critic paper will be able to conclude that the effect is not inconclusive.

There is, indeed, a zero direct effect of democracy on growth. Second, democracy has a significant positive indirect effect on growth through human capital accumulation. In addition, democracies are associated with lower inflation, reduced political instability and higher levels of economic freedom. However, there is some evidence that they are associated also with larger government and more restrictive international trade. Third, there are region-specific effects on the democracy-growth relationship. Particularly, the growth effects of democracy are higher in Latin America and Lower in Asia. This research paper also that much of the variation in results between studies does not reflect real underlying differences in the democracy-growth association Rather it is owing to either sampling error or the research design process.

Raresh Kumar Narayan and Russell Smyth. Democracy and economic growth China: Evidence from counteraction and causality testing. Review of Applied economics, Vol. 2, No, 1, (2006): 81-89 To examine the relationship between the democracy and economic growth in the people's Republic of China over the last three decades. Actually, China represents an interesting case in the debate over the relationship between the democracy and growth. This study was used the short and long run effect of democracy on the china within a production function framework by following the methods of error correction mechanism, and Granger Causality tests-testing between the labor and capital, and most studies by economist have tested for correlation between democracy and economic growth and have failed to adequately address the issue of causation, and using the Granger causality tests to explore the effects of shocks of democracy and economic growth beyond the sample period through the use of variance decomposition analysis and impulse response functions. While labor and capital can defined the core relationship between democracy and economic growth, real GDP and income of people are also the factors, and this study found out the democratization in China is impossible, and it can be true since the China never experience of being democracy. Moreover, economic growth of china is not because of democracy theories, but its own political culture, and its own indigenous development model. Meanwhile, real income and real GDP of each nations are also the factors for democracy growth too.

Actually, according to Paresh Kumar Narayan, and Russell Smyth. (2007), who conducted the similar studies, examined the relationship between the democracy and economic growth in 30 Sub-Saharan African counties, supported the Lipset hypothesis. This study used the real GDP Granger to explore the cause of democracy and an increase in GDP results in an improvement in democracy. In the long run democracy Granger causes real income and an increase in democracy has a positive effect on real income, which is found for Bostwana with the freedome house data and for Madagascare, Rwanda, South Africa, and Swaziland.

However, Hristos Doucouliagos and Mehment Ulubasoglu.(2006). Democracy and Economic Growth: A Meta-Analysis. School Working paper- economic series 2006: Deakin University. This research paper is to explore the inconclusive relationship through a quantitative assessment of the democracy growth literature and use meta-regression as the methodology to analysis by collecting all the existed literature review to conclude the impact of democracy on economic. The strength point of this study was that this study concerned many variable at the same time. For example, it looked beyond the theories, the democracy in the past and the present, and so on.

In addition, Elias Papaioannou and Gregorios Siourounis. (2004). Democratization and Growth. Job market paper: London business school. This research study challenges the empirical finding that democratic institution has direct effect on economic growth by using the before-after event study approach, and controlling the permanent democratization in the specific time. The strength of this study is that it study the long trend, omit the unrelevent variable, and observe the change from one time to other time of the variable affecting the democracy, but the weakness of this research article was that it didn’t distinguish between different types of autocracy for example left or right wing dictatorship and democracy -presidential or parliamentary.

Noam, L and Kanta, Murali. (2009). Does economic development explain democratic development?. Annual meeting at the Midwest political science association. This study explore the relationship between economic and democracy by using the modernization theories to analysis, and observing those change over time. The finding of this study seems to be able to apply for the new current democracy system, but it lacked of concerning about the democratization process in the past. This research study have found out the when there is economic growth, the democratization process will come as well, and according to my perspective, this assumption can be true since when one country has a high economic growth, that nation will prioritize on the domestic affair, freedom and the growth rate of the middle class.

Moreover, the longer period of time, there will be positive effect of democracy, democratization growth, and economic development.

Christian. H. (2010). Inequality, Economic development and democratization. University of Rochester. This research concerned about the inequality, income distribution of the economic sphere and took that variable to analyze the relationship between democracy and economic growth. However, this study focused on two theories-modernization and inequality theories, which was quite similar to Noam, L and Kanta, Murali. (2009). The strength assumption of this study was that when there is economic growth, autocracies more or less will change their political system as well in some extend, but this assumption also failed since some rich autocracies are not more likely to become democratic (Przeworski and Limongi 1997; Prazewoki et al. 2000). Moreover, this study concluded that democracy inequality harms democratization. Of course, in the case of some nations, when there is class tension-between the level of middle class, there will be social clash, which lead to autocratic state more than democracy. What is more, this study fail to analyze other variable beside income inequality since economic crisis, the complexity of democracy system are also the cause of authoritarian shift.

The availability of data and econometric techniques enables all the researchers to investigate these issues empirically. However, the empirical findings span a continuum of negative, insignificant and positive estimates, creating a conundrum. For instance, the distribution of results that we have compiled from 470 regression estimates from 10 democracy-growth studies shows that 16% of the estimates are negative and statistically significant, 20% of the estimates are negative and statistically insignificant, 38% of the estimate are positive and statistically insignificant, and 26% of the estimates are positive and statistically significant. This can be implied that three-quarters of the regressions have not been able to find the desired positive and significant sign. It also implies that around half of the regression models have found statistically significant estimates while the other half found statistically insignificant estimates. Such different results are not surprising because research question posed are narrow and approach the issue from different dimensions. For instance, while certain studies focus on the physical investment channel between democracy and growth, others look at the human capital or political instability channels. Likewise, certain studies present structural estimates of a well-defined model, whereas other focus on the empirical regularities in the data. Thus, the question is perplexed with a continuum of estimates, which differ due to data sources, estimate methodologies, sample composition, and time periods.

The structure of this paper will be followed by the brief review of the key theoretical arguments behind a democracy-growth association, the effect of democracy on economic, the effect of economic on democracy, and conclusion of the research paper.

Theoretical Arguments:

Traditional perspective:

Does political democracy cause the economic growth? To Hobbes (1651), absolutist regimes were more likely to improve public welfare simply because they could not promote their own interests otherwise. Similarly, Huntington (1968) also argues that democracies have weak and fragile political institutions and lend themselves to popular demands at the expense of profitable investments. Democratic governments are vulnerable to demands for redistribution to lower-income groups, and are surrounded by rent-seekers for “ directly unproductive profit-seeking activities” (Krueger 1974, Bhagwati 1982). Non-democratic regimes can implement the hard economic policies necessary for growth, and suppress the growth-retarding demands of low-income earners and labor in general, as well as social instabilities because of ethnic, religious, and class struggles, and Democracies cannot suppress such conflicts. In term of economic progress, markets should come first and authoritarian regimes can more or less easily facilitate such policies. Moreover, some level of development is a pre-requisite for democracy to function properly (Lipset’s 1959 hypothesis). In short, this view implies that political democracy is a best product that cannot be afforded by developing countries. Other proponents of the conflict view and stricter state command on the economy include Galenson (1959), Andreski (1968), Huntington and Dominguez (1975), Rao (19884-5) and Haggard (1990).

The conflict view became more debatable after the growth success stories in South Korea, Taiwan, Hong Kong and Singapore in the 1950s and 1960s. The argument rest on several assumptions, the main one of which is that if given power, authoritarian regimes would behave in a growth-friendly manner. In that regard, server contrasting cases are provided where dictators pursued their own welfare and failed in Africa and the Socialist world (de Haan and Sirermann 1995, Alesina et al. 1996).

Proponents of democracy, on the other hand, argue that rulers are potential looters (Harrington 1656) and democratic institutions can act to constrain them. Most of the assumptions of the conflict view can be refuted with good reasons. Implementation of the rule of law, contract enforcement and protection property rights do not necessarily imply an authoritarian regime. In addition, Bhagwati (1995) argues that democracies rarely engage in military conflict with each other, and this promotes world peace and economic growth. They are also more likely to provide less volatile economic performance. Finally, de Haan and Siermann (1995) note that a strong state and an authoritarian state are not the same thing. However, markets can deliver growth under both democratic and authoritarian regimes.

The modern perspective

Actually, the political democracy-growth can be seen more precise and focused today. Theory has moved away from traditional conflict with compatibility arguments, because different aspects of the broader institutions-growth problem have been identified. For instance, many researchers have separated economic democracy from political democracy. Factors like protection of property rights, business, credit and labor market regulation, which were previously attributed to political democracy, are now being treated as part of economic democracy. Analysis of economic freedom indicators from the Fraser institute (by Gwartney and Lawson 1996, 2000, 2003) and the heritage Foundation (by O’Driscoll et al. 2003) has shown that economic freedom, with also its other aspects, is equally relevant to growth. Recently, the world bank introduced the ” Doing Business” aspect of institutions problem. In particular Djankov et al (2002a, 200b, 2005), Djankov, McLeish and Shleifer (2005), and Botero et al (2004) benchmarked business regulations and quantified the easiness of private sector's activity in the economics based on labor hiring and firing practices; ease of starting, registering and closing business; protecting investors and enforcing contracts; and dealing with license and paying taxes.

At this point one may feel that dissecting these aspect from political democracy reduce its scope to multi-party and free election only. Of course, political democracy is more than free and fair elections. First, empirical evidence shows that all the aspects of the institutions made precise above, i. e., economic democracy, governance and private sphere in the economy have high correlations with political democracy. In other words, the mere existence of participatory democracy implies the broader institutions conducive to growth.

Secondly, various studies find that political democracy has enormous indirect effects on growth through human capital accumulation, income distribution, and political stability. In addition, Sturn and de Haan (2001) find that the presence of democracy in a country positively affects the level of economic freedom. Thus, on the question of political democracy and growth, one should remember the broader associations that encompass the channels, or the indirect effects, between democracy and growth rather than one to one causation from regime to growth.

Thirdly, as Bhagwati(1995) and Rodrik (2000) point out, democracies provide higher quality growth through various means. Rodirk puts it in the following way: participatory democracies enable a higher-quality growth by allowing greater predictability and stability in the long run, by being stronger against external shocks, and by delivering better distributional outcomes. Democratic institutions would help market function” perfectly”, as is assumed in neoclassical economic models. As an extension to such argument, the “ volatility” channel has also been shown to be an important indirect effect of democracy on growth. Non democratic regimes are not a homogenous lot (de Haan and Siermann, 1995, Alesina et al. 1996, Alesina and Perotti 1994), whereas democracies are more homogenous and can provide stable economic progress.

Effect of democracy on Growth:

Sirowy and Inkeless (1990) suggest that there are three major views on the effects of democracy on growth with their label the “ conflict”, and the compatibility” and the “ skeptical”. The conflict thesis suggests that democracy and economic growth are incompatible because elected officals longing for popular approval make shortsighted decisions designed to maximize whose objective is to divert resources from productive activities in favor of immediate consumption. Related arguments are that democracy is less conducive to long term stability (world Bank, 1991, pp. 132-133) or long term development (Barro, 1996) because of the tendency in majority voting systems to enact rich to poor redistribution of income including land reforms.

On the other hand, the compatibility thesis proffers that democratic features such as political pluralism, institutional checks and balances and freedom of the press provide safeguards against system abuse or predatory behavior often associated with authoritarian regimes. Friedman (1962) was one of the first to suggest that economic and political freedoms are mutually reinforcing. He postulated that an expansion in political freedom fosters economic freedoms such as secure property rights and certainty of contract, which, in turn, underpin higher rates of economic growth. As Barro(1996) argues, of course there is nothing in principle preventing non-democratic governments from promoting economic freedoms. Examples of autocracies which have increased economic freedom include the Pinochet regime in chile and the Fujimora government in Peru. The point, though, made by advocates of the compatibility thesis is democracy is more likely to be conducive to promoting economic freedoms than authoritarianism because the political legitimacy and therefore long term survival of a democracy depends on maintaining economic rights.

The third perspective, which is the skeptical view, suggests there is no systematic relationship between democracy and economic growth. While it might generally be true that there is more economic freedom under a democracy than an autocracy, there is no guarantee it will be at an optimum (Esposto and Zaleski. 1999). Even in a democracy there will be those whose aims is to challenges the private property status quo if it is in their best interests, and because of the very nature of a democracy they will have more opportunities to do so(Przewoki and Limongi, 1993).

However, the empirical evidence on the three perspectives in not clear-cut. Sirowry and inkeles(1990) review thirteen studies; of which, six supported the skeptical view, four suggested qualified or conditional relationships, and three provided unconditional support for the conflict perspective. In a later survey, Brunetti (1997) reviewed 17 empirical studies of the democracy-growth relationship. He found (at p. 167) " nine studies report no relationship, one study a positive, one study a negative, three studies a fragile negative relationship and three studies a fragile positive relationship between democracy and economic growth”. Helliwell (1994), Barro (1996) and Tavares and Waczing (2001) found that democracy has either a non-significant or moderately weak negative effect on growth once other growth-determining variables are held constant. On the basis of the mixed findings in the literature, a reasonable conclusion is that: ” We do not know whether democracy fosters or hinders growth” (Przewoki and Limongi, 1993, P. 64). However, as a provision to this, the balance of empirical evidence is with the conflict and skeptical views rather than the compatibility view.

Effect of growth on Democracy:

Political scientists have examined the effect of the economic growth on democracy. Most studies have found that economic growth generates demands for political right (Lipset, 1959; Bollen, 1979; Bollen and Jackman, 1985; Burkhart and Lewis-Beck, 1994). At one level, casual empiricism seems to also support the view that economic growth promotes democracy. As Gupta et al. (1998, pp. 589-590) note, ” all of the developed, industrialized nations have a democratic political system. In contrast, most of the nations in the poorest segment of the world community operate under various forms of non-democratic political system”. However, This is not ture in a blanket sense. Casual observation also suggests that economic growth does not necessarily bring about a demand for democracy. There are examples of authoritarian regimes in Southeast Asia and the Middle East where citizens are willing to forego demand for political liberalization provided their economic needs are being met.

In these instance there is a good argument that it is only when the authoritarians government stops delivering on the economic front that there are calls for more political rights. An example is the fall of the Suharto regime in Indonesia following the Asian financial crisis when spiraling inflation and unemployment prevented Suharto from delivering in the economic sphere. Glasure et al. (1999) obtain results that are consistent with this view. Their finding suggest that in developing countries and newly industrializing countries economic development has a significant effect on democratic performance, but contrary to Lipest(1959) economic development leads to lower levels of democracy. Glasure et al. (1999, p. 475) conclude: ” The sign reversal may stem from the possibility that as nations strive for economic development, the nation’s tend to trade off democracy for economic development”

Discussion of the results:

In the result using the Freedom House dataset, Botswana stands out as the one country where there is support for both the compatibility and Lipset hypothese, i. e. there is Granger causality between democracy and real GDP in the long run, and democracy and real GDP have a positive effect on each other. The results using the Beck et al. (2001) dataset confirm long-run Granger causality running from GDP to democracy and the GDP has positive effect on democracy. The democracy growth is well established in Botswana. The OECD (1999, p. 29) posited: “ Political stability has result from… favorable economic conditions”. While this is true, Botswana’s economic success has also been built on democratic tradition in which there are no narrow ethnic-based interest groups with distinct means of expression, which has avoided infighting over diamonds and other political issue (Wiseman, 1990).

Of course, Botswana has been described as an African success story (Acemoglu et al., 2001) with the highest growth rate of any country in the world between 1960 and 1999. From 1965 to 1973 Bostswana's annual rate of growth of GDP was 14. 8% which was the highest in the world except for the high income oil rich Oman (21. 9%). From 1973 to 1984 Botswana's annual growth rate was 10. 7% which was the highest in the world, outstripping Asian Tigers, Hong Kong (9. 1%) and Singapore (8. 2%) (World Bank, 1986). Between 1980 and 1990 Botswana grew at 11%, also the highest in the world over this period, with China second at 10. 3% per annum. From 1990 to 2003 Botswana's growth slowed to 5. 2% but was still in the top dozen countries in the World Bank world Development indicators list of countries over this period (World Bank, 2005). Botswana is one of only a few African countries with a democratic tradition (Wiseman, 1990). It has had continuous democracy since obtaining independence in 1996. The discovery of diamond mines has facilitated economic growth, but there is more to Botswana's success than simply having abundant natural resources. There is universal agreement that the Botswana government has used the revenue from diamonds to pursue good policies (See e. g Acemoglu et al., 2001).

Conclusion:

The aim of this paper was to review the accumulated evidence on the impact of the democracy on economic growth. Existing studies and authors of primary studies have drawn inferences from only a limited set of information and have failed to reach a decisive conclusion. In contrast, I apply analysis, critic to the pool of 6 studies with 10 published estimates of the democracy-growth associations, and are able to draw other variables conclusions. This in line with Bhagwati's (1995) prediction that democracy does not handicap development. Second, while the direct effect is found to be Zero, this research paper's result indicates that democracy has significant indirect effects on growth through various channels. In particular, this study also finds that democracy has a favorable impact on human capital formation, on the level of economic freedom, inflation and political instability. However, This study also find that democracy is associated with greater government spending and less free international trade. Third, while there is no evidence of a democracy-growth effect for all countries combined all together, there are clear regional effects. The available evidence suggests that democracy has a larger effect on economic growth in Latin America, and that this is lower in Asia. Moreover, it appears that there is country-specific effect like China. Fourth, by comparing the democracy-growth association to research conducted elsewhere on the economic freedom growth assocaiton(Doucouliagos and Ulubasoglu 2006), we find that democracy's direct effect on growth is zero, while economic freedom has a positive direct effect.

In short, this research paper conclude that the empirical evidence that has accumulate over the past 40 years points to a zero direct effect on growth and significant direct effects on growth through factor accumulation, economic freedom, inflation and openness, with an adverse effect through government spending. The net effect is that democracy does not harm economic performance.

This analysis paper can be applied to other dimension of democracy. For example, the links between democracy and the level of development rather than growth, the channels through which democracy impacts on both growth and development, as well as the determinants of democracy, are all promising areas for future research analysis to make more inclusive result.