

**Institutions and Economic Growth:
A Survey of the Recent Empirical Evidence**

Gebhard Kirchgässner

**University of St. Gallen,
Swiss Institute of International Economics
and Applied Economic Analysis (SIAW-HSG),
CESifo and Leopoldina**

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1 Introduction

2 Natural Experiments: Korea and Germany

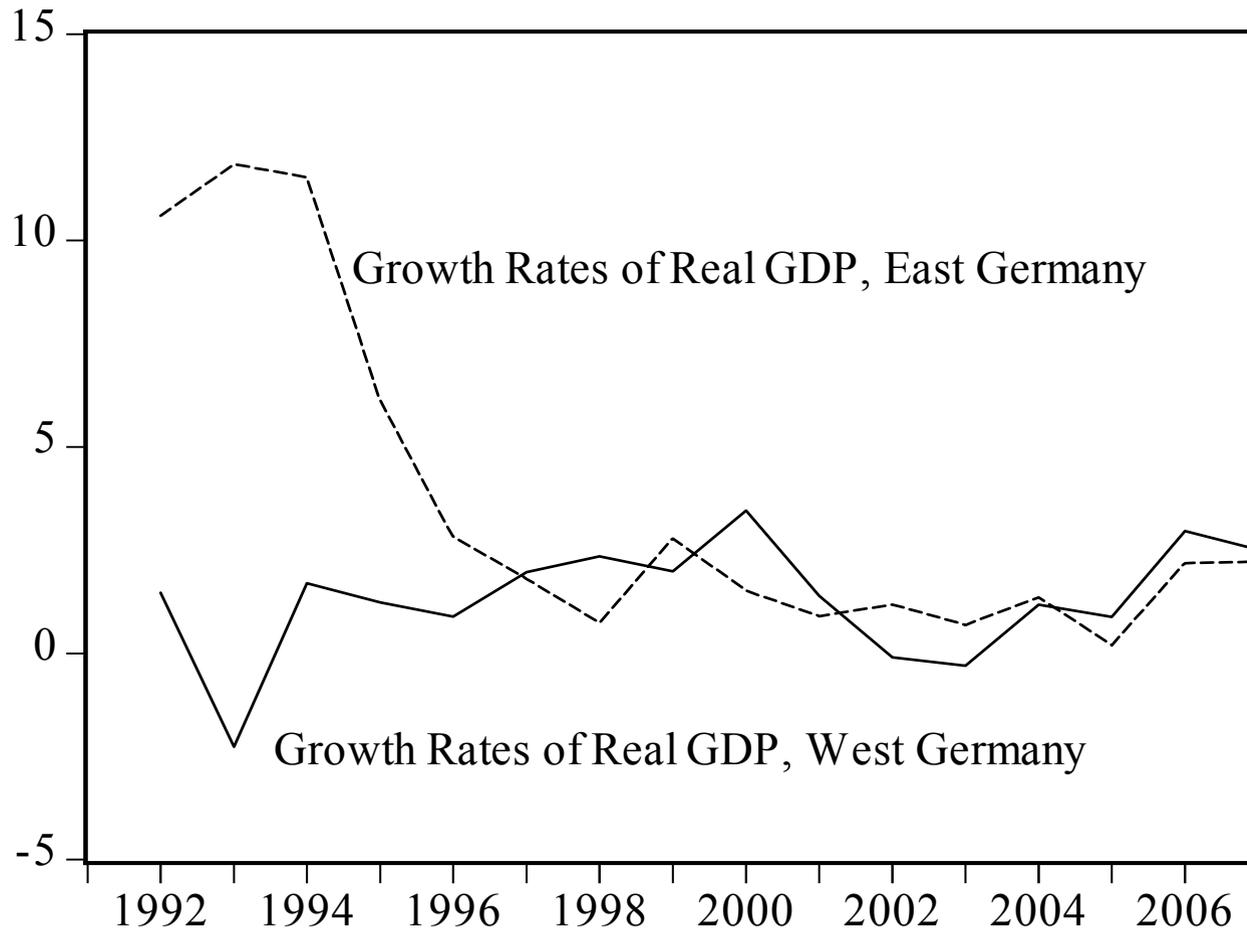
(i) Korea

GDP p.c.: 25'000 \$ versus 1'700 \$ (2007)
(up to the seventies only economic institutions)

(i) Germany

GDP p.c.: 21'000 DM versus 7'000 DM (1991)
(economic and political institutions)

1 Introduction (2)



Traditional Growth Theory (SOLOW (1956)):

Labour, Capital, Technical Progress (exogenous)

Theory of Endogenous Growth (BARRO/SALA-I-MATIN (1995))

Labour, Capital, Technical Progress (endogenous)

Recent discussion (Harvard/MIT)

- (i) Institutions vs. Geography**
- (ii) Institutions vs. Governance (Policy)**
The role of democratic institutions

but:

- (i) No discussion of direct democracy**
- (ii) Hardly any discussion of federalism**

2 Discussions:

- (i) The role of institutions for economic development
(of less developed countries)**
- (ii) The role of institutions in developed countries**



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- 1 Introduction**
- 2 Institutions, Governance or Geography?**
- 3 The Role of Economic Institutions**
- 4 The Role of Political Institutions**
- 5 Direct Democracy and Economic Growth**
- 6 Federalism and Economic Growth**
- 7 Concluding Remarks**

2 Institutions, Governance or Geography?

(i) Institutions vs. Geography

Geography (SACHS)

“GDP densities in temperate ecozones proximate to the sea are on average eighteen times higher than in non-proximate non-temperate areas”

MELLINGER/SACHS/GALLUP (2000)

Institutions (ACEMOGLU, RODRIK)

⇒ Geography might have some (transitory) impact,
but institutions are relevant for policy.



2 Institutions, Governance or Geography? (2)

(i) Institutions vs. Governance (Policy)

Governance / Human Capital (GLAESER)

“(a) human capital is a more basic source of growth than are institutions, (b) poor countries get out of poverty through good policies, often pursued by dictators, and (c) subsequently improve their political institutions”

GLAESER, LA PORTA/SHLEIFER (2004)

Institutions (ACEMOGLU)

“institutions are the fundamental cause of long-run growth”

ACEMOGLU/JOHNSON/ROBINSON (2005)

⇒ Both, institutions and governance (policy) matter.

(Problems of identification)

but: What are ‘institutions’?

(political vs. economic institutions)



3 The Role of Economic Institutions

- (i) Important for economic development:
basic economic liberties / private property rights / rule of law
Questions:
- Has economic liberty only an impact on income or also on (long-run) income growth?
 - Is there a publication bias in the results?
- (ia) **Credibility** of rules
(BRUNETTI/KISONKO/WEDER (1998))
- (ib) The role of the judiciary
De jure vs. de facto independence (FELD/VOIGT(2003, 2005))
- (ic) Legal reforms and **informal legal structures**
(MESSIK (1999))



3 The Role of Economic Institutions (2)

(ii) **Openness** of an economy:

(**RICARDO** (1817))

Theoretical basis of EU, EFTA, NAFTA, GATT, WTO, ...

(iia) Which openness?

Liberalisation of capital vs. goods markets (**STIGLITZ** (2002))

(iib) Is openness really good for growth?

“trade liberalization does not have a simple and straightforward relationship with growth using a large number of openness measures for a cross-section of countries over the last three decades.”

(**RODROGUEZ/RODRIK** (2000))

“lower trade barriers in combination with a stable and non-discriminatory exchange-rate system, prudent monetary and fiscal policies and corruption-free administration of economic policies promote economic growth”

(**BALDWIN** (2003))



3 The Role of Economic Institutions (3)

(iib) **Openness** of an economy:

“democracy and the rule of law are both good for economic performance, but the latter has a much stronger impact on incomes. Openness (trade/GDP) has a negative impact on income levels and democracy, but a positive impact on the rule of law. Higher income produces greater openness and better institutions, but these effects are not very strong”

(RIGOBOHN/RODRIK (2005))

(iic) Trade barriers might foster growth.

“while trade barriers have adverse effects on growth through reducing trade, they positively affect growth through superior resource allocation and/or positive externalities”

(YANIKKAYA (2002))

(iid) Tariffs might be an optimal way to finance a government in a less developed country.



3 The Role of Economic Institutions (4)

Economic Institutions: Results

- (i) Economic freedom is good for economic development (income), not necessarily also for long-run growth.**
- (ii) De facto independence of the judiciary is more important than de jure independence.**
- (iii) It is open whether (or when) developing countries should open financial markets and not only goods markets.**
- (iv) An increase in openness does not necessarily have a positive impact on economic development.**



4 The Role of Political Institutions

(i) **Political (Policy) Variability:**

(**FATÁS/MIHOV (2005)**, **JONG-A-PIN (2006)**)

Permanent or transitory losses?

(ii) **What is the effect of democracy?**

'economic is more important than political liberty'

(**HAYEK (1977)**)

“The political economy of development poses a cruel choice between rapid (self-sustained) expansion and democratic process.”

(**BHAGWATI (1966)**)

Casual evidence: Some authoritarian countries did grow very fast.

but: Not only the best but also the worst performers in economic

growth are autocracies.

(**ALMEIDA/FERREIRA (2002)**)

⇒

Does the trade-off between democracy and economic



4 The Role of Political Institutions (2)

(iii) Empirical Results (I):

(a) Negative Effects:

BARRO (1996)

(b) Positive Effects:

SALA-I-MARTIN (1997)

MINIER (1998)

RODRIK (2000)

RIGOBON/RODRIK (2005)

TAVARES/WACZIARG (2001)

BUTKIEWITZ/YANIKKAYA (2006)

(c) No significant Effects:

DURHAM (1999)

⇒ No clear picture; positive effects are often significant but rather small.



4 The Role of Political Institutions (3)

(iv) Empirical Results (II):

(a) **Positive Effects**: Permanent democracies with a parliamentary system and proportional representation

Negative Effects: Temporary democracies with a presidential system and a majoritarian voting system

PERSSON (2005)

but: Positive effects of a presidential system

PERSSON/TABELLINI (2006)

(b) **Positive Effect of ‘Democratic capital’**

PERSSON/TABELLINI (2006a)

(c) **Negative Effects of a change from a democratic to an authoritarian system**

PERSSON/TABELLINI (2007)



4 The Role of Political Institutions (4)

Political Institutions: Results

- (i) **Political Variability is detrimental for economic growth.**
- (ii) **The effect of democracy on economic growth is small; it does not have to be positive, but:**
- (iii) **The ‘cruel choice’ of Bhagwati is not the reality.**

5 Direct Democracy and Economic Growth

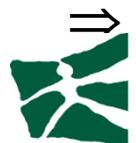
Proposition: Low growth in Switzerland is due to extensive direct democracy and (fiscal) federalism
(**BORNER/BRUNETTI/STRAUBHAAR (1990),
WIDMANN**)

Empirical Results

- (i) **International Evidence:**
Direct democracies perform better.
(**Voight (2000)**)
- (ii) **Switzerland as a laboratory:**
Cantons with more direct popular rights perform better.
(**FELD/SAVIOZ (1997)**)
(**KIRCHGÄSSNER/FELD/SAVIOZ (1999)**)
(**FREITAG/VATTER (2000)**)
but: **GERMAN (1999)**.



There is no reason to assume that a direct democracy performs
than a purely representative one.



6 Federalism and Economic Growth

Theoretical propositions:

Positive Effects:

Tiebout (1996), Oates (1972)

Brennan/Buchanan (1977, 1980)

Negative Effects:

ZODROW/MIESZKOWSKI (1986), SINN (1997)

Empirical Results

(i) **Meta Analysis:**

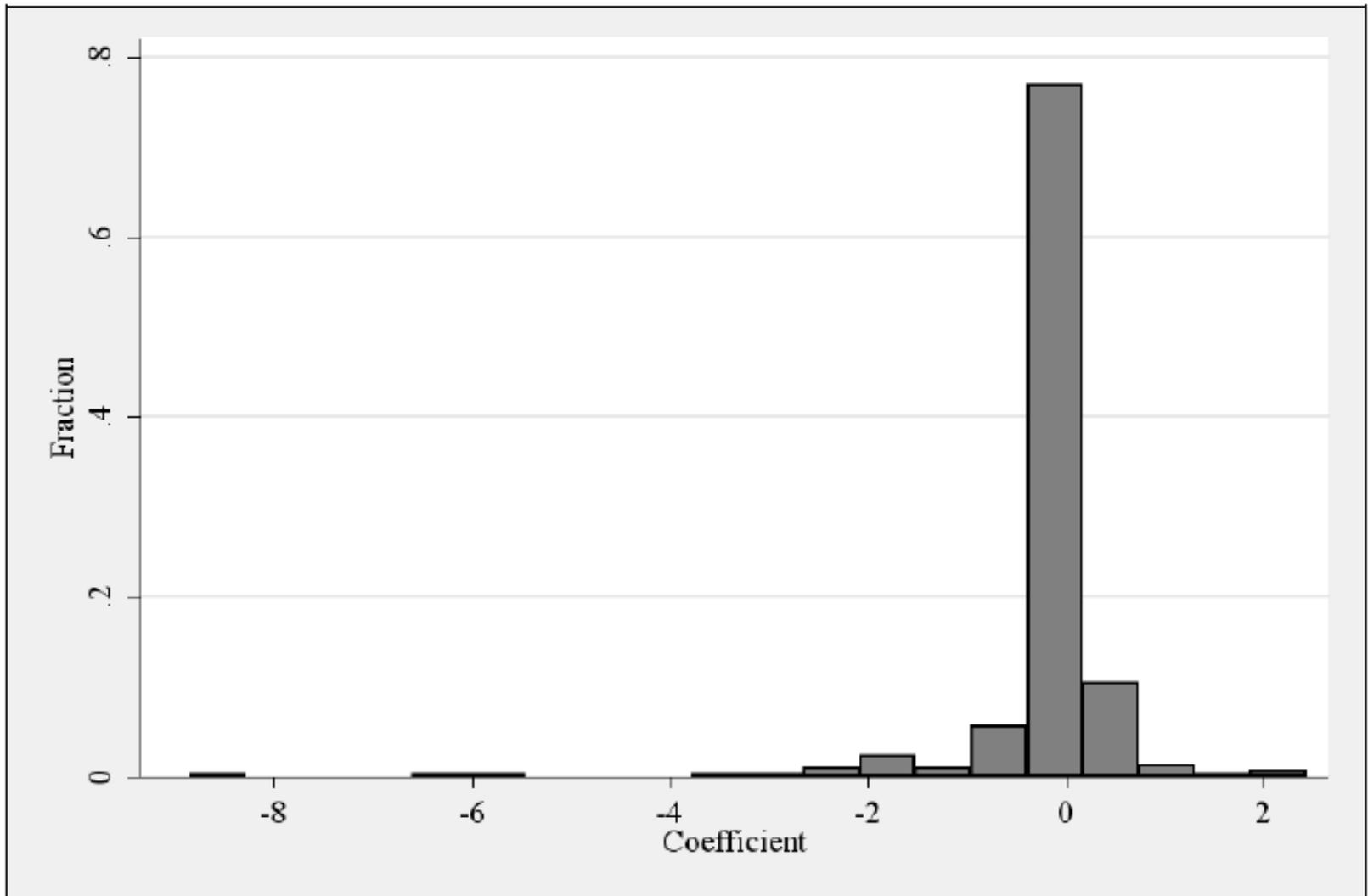
No significant impact

(mean coefficient: -0.13, mean t-statistic: 0.158)

(FELD/BASKARAN/SCHNELLENBACH (2008))

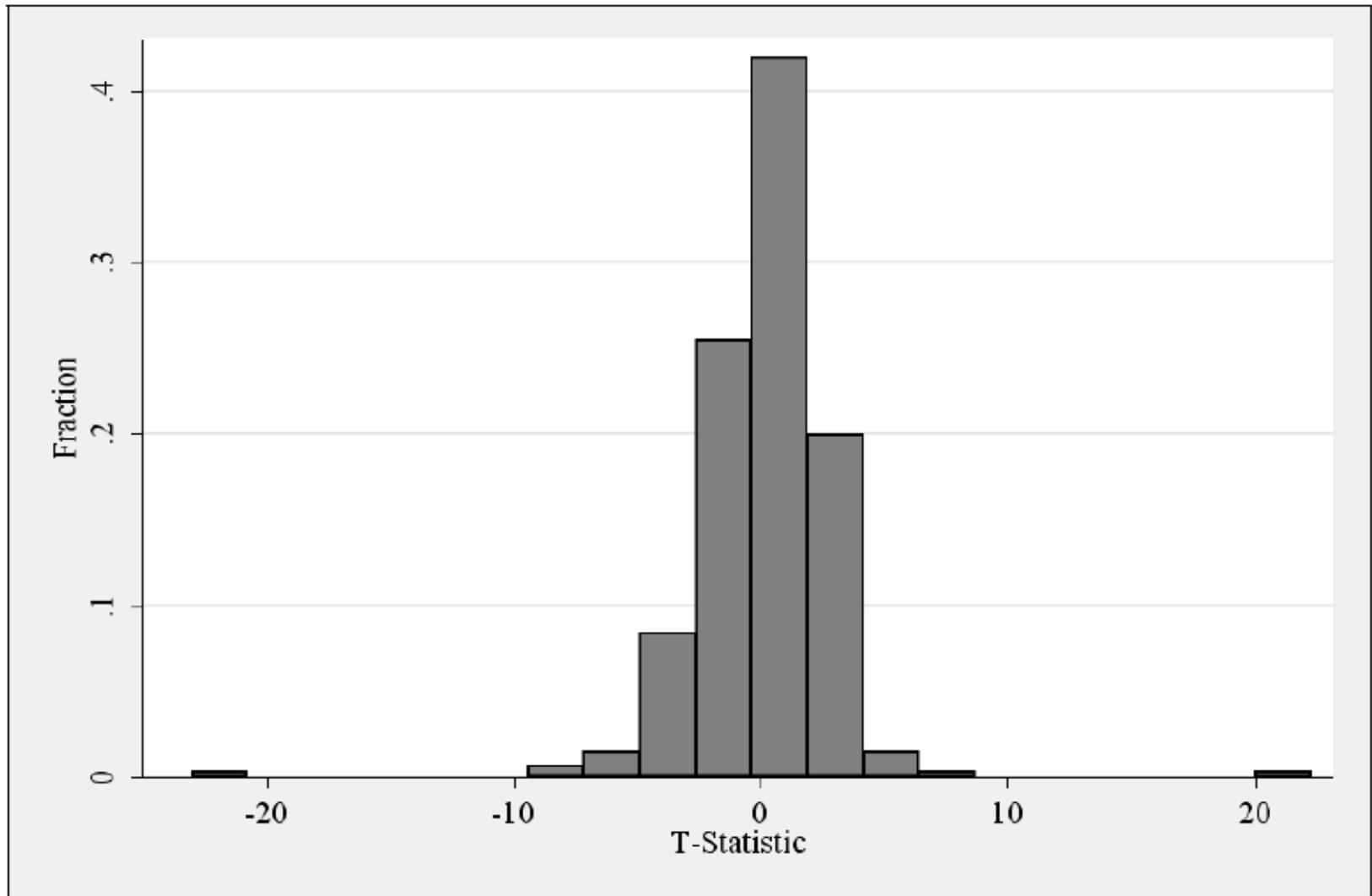


6 Federalism and Economic Growth (2)



Estimated coefficients for the effects of fiscal decentralisation on economic growth

6 Federalism and Economic Growth (3)



*Estimated t-statistics for the effects of fiscal decentralisation
on economic growth*



6 Federalism and Economic Growth (4)

3 groups of studies:

- (i) **Developing countries**
 - (ii) **Developed (OECD) countries**
 - (iii) **Single country studies**
 - a) **Time series analyses**
 - b) **Panel analyses**
- ⇒ **no clear result**

Problems

- a) **nonlinearity**
- b) **optimal adjustment**

⇒ **There is no indication that (fiscal federalism) has especially positive or negative effects on economic growth**



(i) Clear Results:

- a) **At least some institutions have a clear impact.**
- b) **Positive effect of economic freedom**
- c) **Negative effect of political (policy) variability**

(ii) Open Results:

- a) **Effects on long-run economic growth**
- b) **Effects of openness**
- c) **Effects of democracy (direct democracy)**
- d) **Effects of fiscal federalism**

but: (Direct) democracy and (fiscal) Federalism have value in themselves.

Problems:

- a) **Data**
 - b) **Simultaneity**
- ⇒ Results depend to a large extent on the data used and the specification of the estimated equations.**

(CICCONE/JAROCINSKI (2007))



7 Concluding Remarks (2)

Conclusions for Switzerland:

- a) **Reform of direct democracy?**
- b) **Re-organisation of the cantons?**
- ⇒ **There are other (better) possibilities to increase economic growth in Switzerland**



Thank you very much for your attention!