



**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

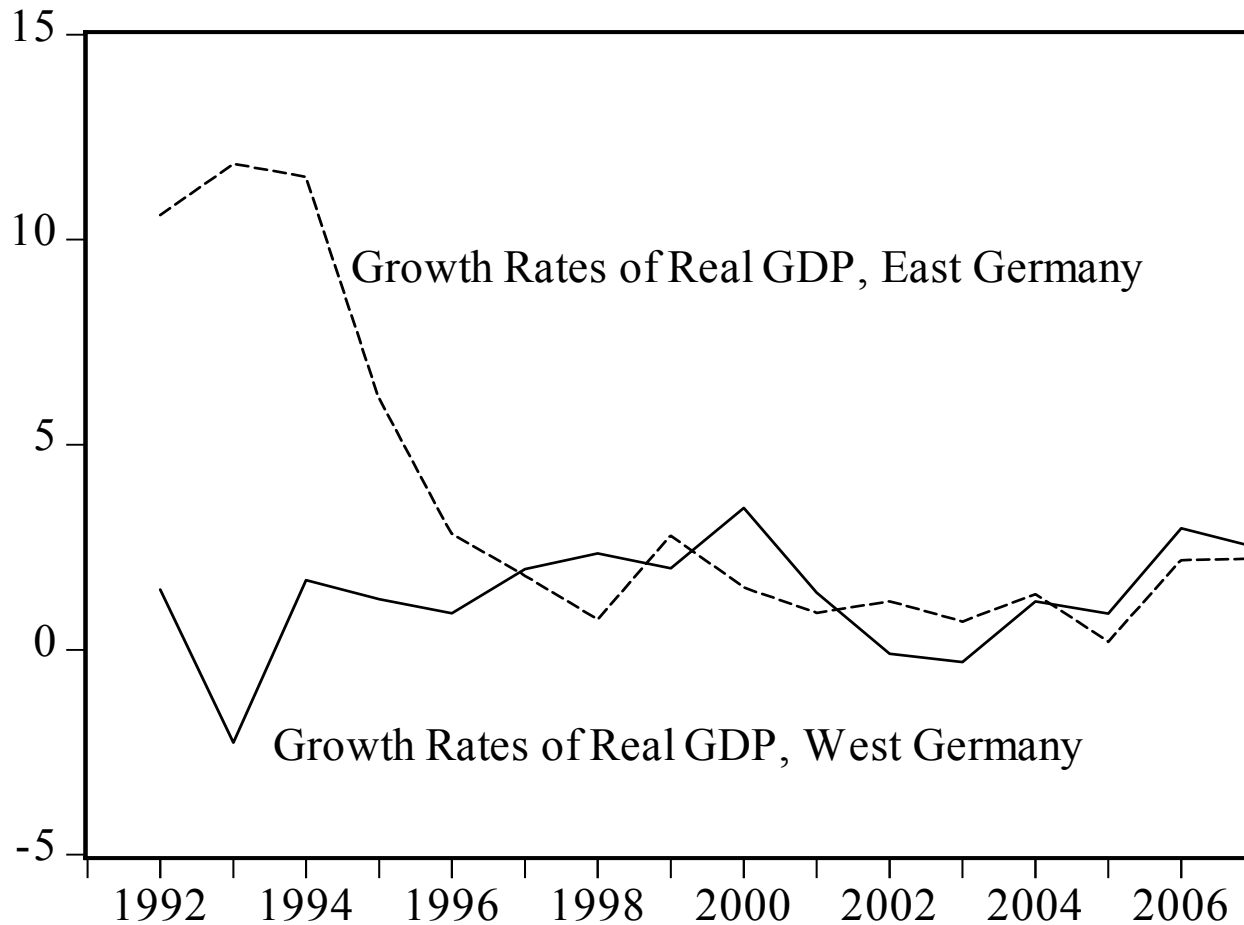
(i) Korea

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

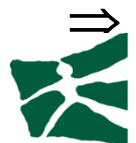
Proposition: Low growth in Switzerland is due to extensive direct democracy and (fiscal) federalism
(**BORNER/BRUNETTI/STRAUBHAAR (1990),
WIDMANN**)

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:**

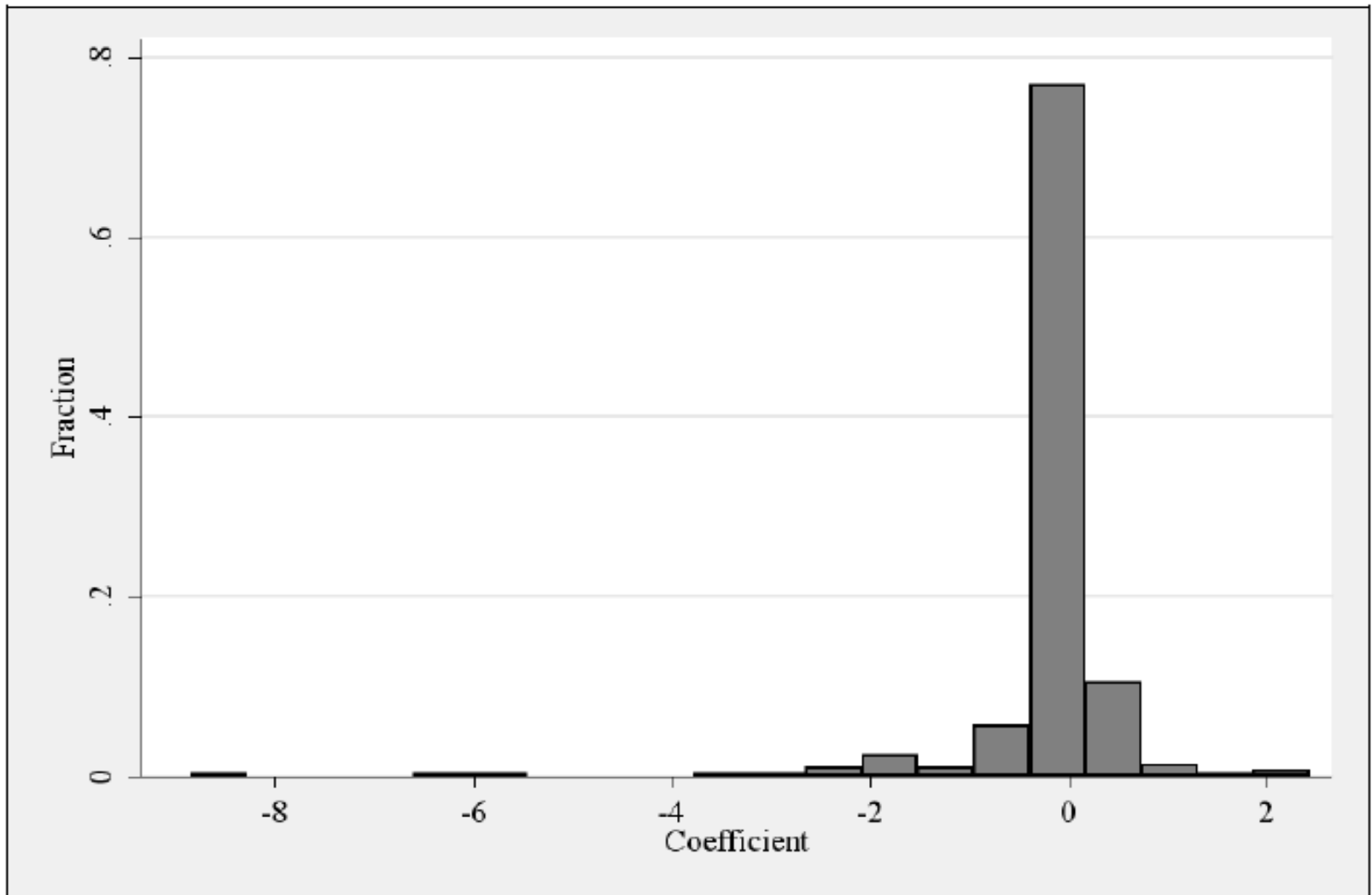
No significant impact

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

(FELD/BASKARAN/SCHNELLENBACH (2008))

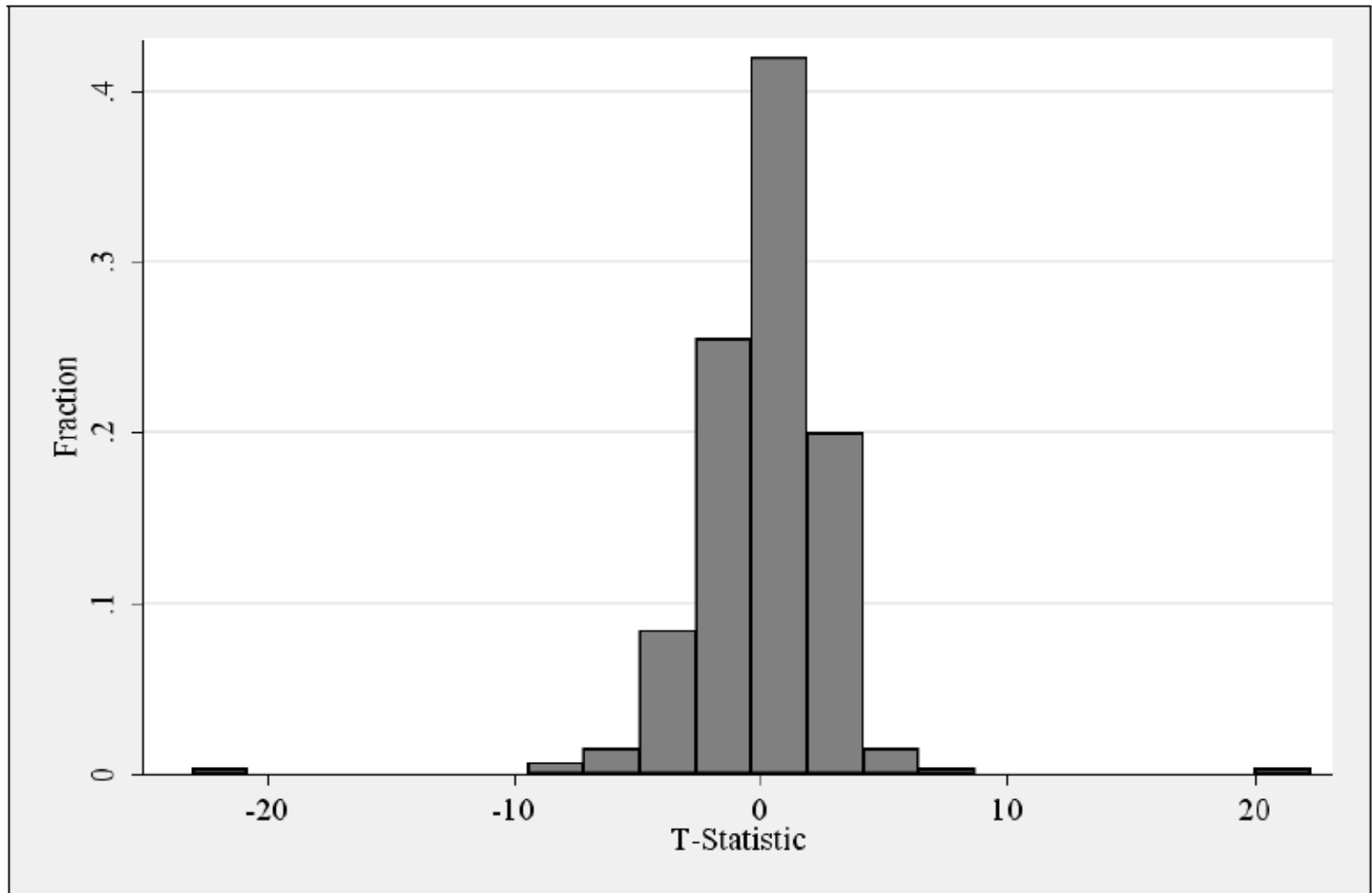


6 Federalism and Economic Growth (2)



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!