

Democratic transitions and institutional change

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1 Introduction

- ◉ An Institutional environment that is more consistent with economic freedom improves long-run growth rates.

(e.g. Pitlik 2002, Berggren 2003, Gwartney et al 2006, de Haan et al 2006, Doucouliagos and Ulubasoglu 2006, Rode and Coll 2012)

 What are the political determinants of market oriented institutions?

- ◉ question on the usefulness of *developmental dictatorships* (S. Korea, Taiwan, Chile, PR China?, Egypt?)
- ◉ threat of electoral backlash may prevent economic reforms in developing countries from being implemented (Haggard and Kaufmann 1995, Roland 2000)
- ◉ Other authors find that democracy exerts a decidedly positive impact on institutional development:
de Vanssay and Spindler (2002), de Haan and Sturm (2003), Lundström (2003), Pitlik and Wirth (2003), de Vanssay et al. (2005), Pitlik (2008), Prior (2009), Lawson and Clark (2010)

1 Introduction

- “Democratic decision-making provides governments with legitimacy, which enhances their ability to implement liberal institutional reforms that sometimes involve high transitional costs.” (de Haan and Sturm, 2003)
- Consistent with the view that a possible income-effect of democracy operates principally through economic freedom: Fidrmuc (2003), Vega-Gordillo and Álvarez-Arce (2003), Xu and Li (2008), Klomp and de Haan 2009, etc.
- Most of the prior studies have examined the relationship between the **level of democracy** and changes in economic freedom.
- Rode and Gwartney (2012) examine the potential impact of **transitions to democracy** on economic liberalization. Practically no prior empirical work on this topic.
 - > Stable democratic transitions have a positive impact on economic freedom. (inverted U pattern)
 - > Unstable transitions have an adverse effect.
 - > Stable democracies probably achieve larger increases than autocracies.

1 Introduction

- Rode and Gwartney (2012) only focus on *comprehensive economic liberalization*.



What about the impact of democratic transitions on the individual components of economic institutions?

- Our paper extends their work, using the areas of the Economic Freedom of the World (EFW) index to measure changes in the components of institutions and central parts of economic policy.
- A number of empirical studies focus on the relation between democracy and what could be considered elements of economic freedom:
 - Link btw democracy and government size or trade barriers is more popular than connection with property rights, inflation, and regulation.
Boix (2001), Aidt and Jensen (2009), Boix (2003), Knutsen (2011), Armijo (2005), Milner and Mukherjee (2009), Bjørnskov (2012), Bediev et al. (2012), etc.
 - No unanimous conclusions and contradicting findings!
 - Causality?
- Instrument for transitions to control for the possible endogeneity of democratization. (i.e. Knutsen, 2011)

2 Data and research strategy

- Areas of the EFW index by Gwartney et al. (2012) are used to measure individual elements of economic institutions:
 1. Size of government
 2. Legal structure and property rights
 3. Sound money
 4. Freedom to trade
 5. Regulation of credit, labor, and business
- Transitions to and from democracy are identified and measured with a dataset by Cheibub et al. (2010), using contestability of elections to classify countries as democratic or dictatorial. (DD)
- Definition of democracy as free and fair elections that determine a country's legislative and executive offices.
 - > "Reductionist." (e.g. equality before the law, constraints on executive, freedom of the press, etc.)
- Broader measures of democracy, for example Freedom House or Polity iv entail the following problems:
 1. Significance of middle categories?
 2. Overly subjective evaluations of additional concepts.
 3. Difficult to clearly distinguish between dimensions and consequences.
 4. Arbitrary decisions regarding the identification of transitions.

2 Data and research strategy

- ◉ Dependent variable is the change in the EFW index areas.
- ◉ Control variables:
 1. initial EFW area
 2. log initial GDP per capita (PPP)
 3. Initial average value of remaining EFW areas

- ◉ We define 2 binary variables with the DD dataset:
 1. Democracy/Democratization
 2. Unstable regime (coups +/-10y)
 - stable Authoritarian regimes as reference point

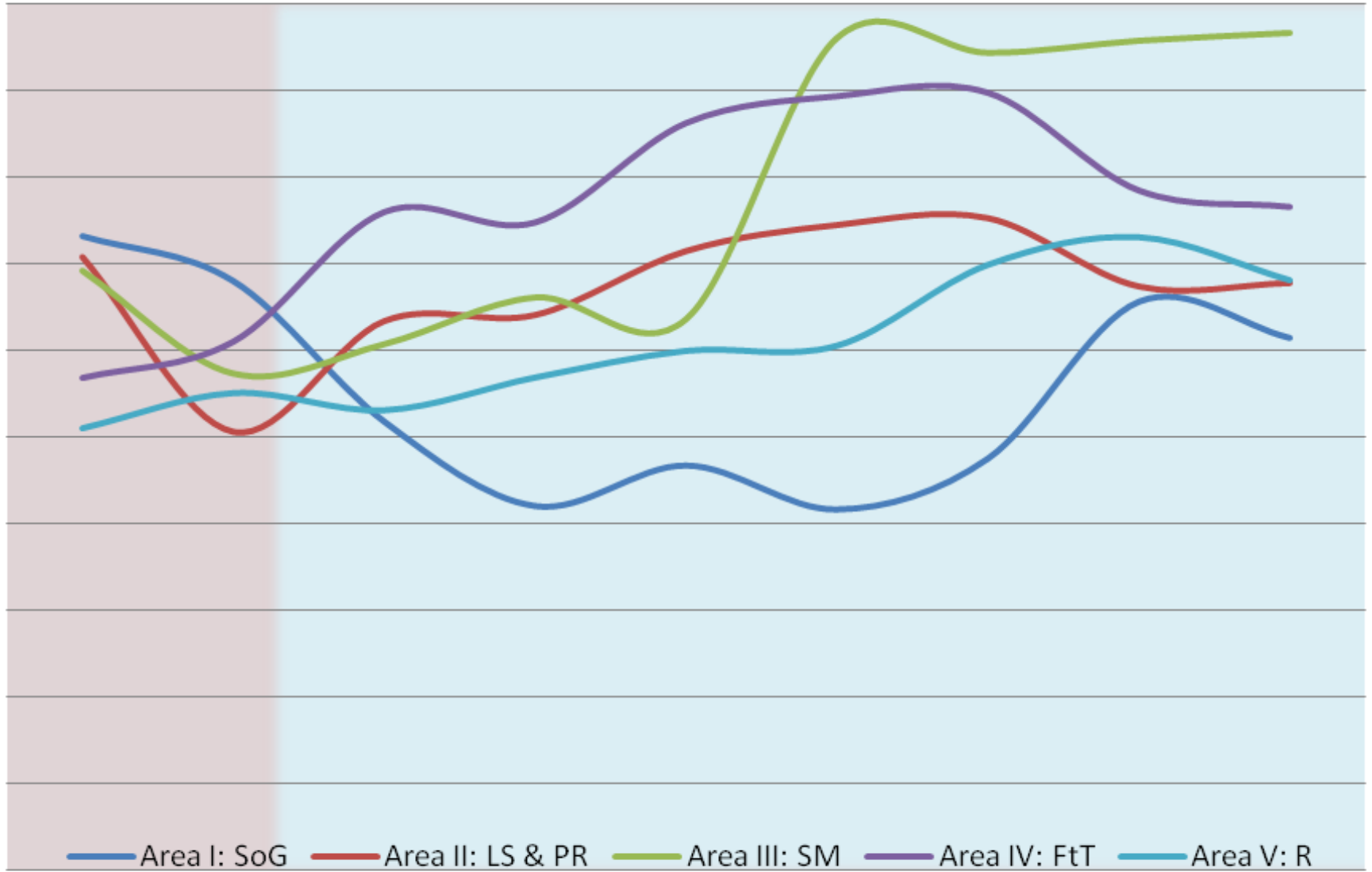
- ◉ IV for transitions is based on observations by Huntington (1991) that democracy has spread across the globe in 3 distinct waves.
 - Following Knutsen (2011) variable is a zero in case of a country's current regime originating before 1827, between 1922-42, or 1958-75. All other cases are scored one.

Autocracies		Democracies		Democratizations		
				Stable transitions		Unstable transitions
Algeria	Rwanda	Australia	Israel	Benin (1991)	Philippines (1986)	Argentina (1983)
Bahrain	Singapore	Austria	Italy	Bolivia (1983)	Portugal (1976)	Bangladesh (1986)
Botswana	South Africa	Bahamas	Jamaica	Brazil (1985)	Senegal (2000)	Burundi (1993)
Cameroon	Syria	Barbados	Japan	Chile (1990)	Spain (1977)	Congo, Rep. (1992)
Chad	Tanzania	Belgium	Luxembourg	Cyprus (1983)	Taiwan (1996)	Ecuador (1979/2002)
China	Togo	Belize	Malta	El Salvador (1984)	Uruguay (1985)	Fiji (1992)
Congo, D. Rep.	Tunisia	Canada	Mauritius	Honduras (1982)		Ghana (1993)
Cote d'Ivoire	Uganda	Columbia	Netherlands	Hungary (1990)		Guatemala (1986)
Egypt	UAE	Costa Rica	New Zealand	Indonesia (1999)		Nepal (1990)
Gabon	Zambia	Denmark	Norway	Kenya (1999)		Niger (1993)
Haiti	Zimbabwe	Dominican Rep.	Sweden	Korea, Rep. (1988)		Nigeria (1979/1999)
Iran		Finland	Switzerland	Madagascar (1993)		Pakistan (1988)
Jordan		France	Trinidad Tobago	Malawi (1994)		Peru (1980/2001)
Kuwait		Germany	UK	Mali (1992)		Sierra Leone (1998)
Malaysia		Greece	USA	Mexico (2000)		Sri Lanka (1989)
Morocco		Iceland	Venezuela	Nicaragua (1984)		Thailand (1979)
Namibia		India		Panama (1989)		Turkey (1983)
Oman		Ireland		Paraguay (1989)		
29		34		24		17

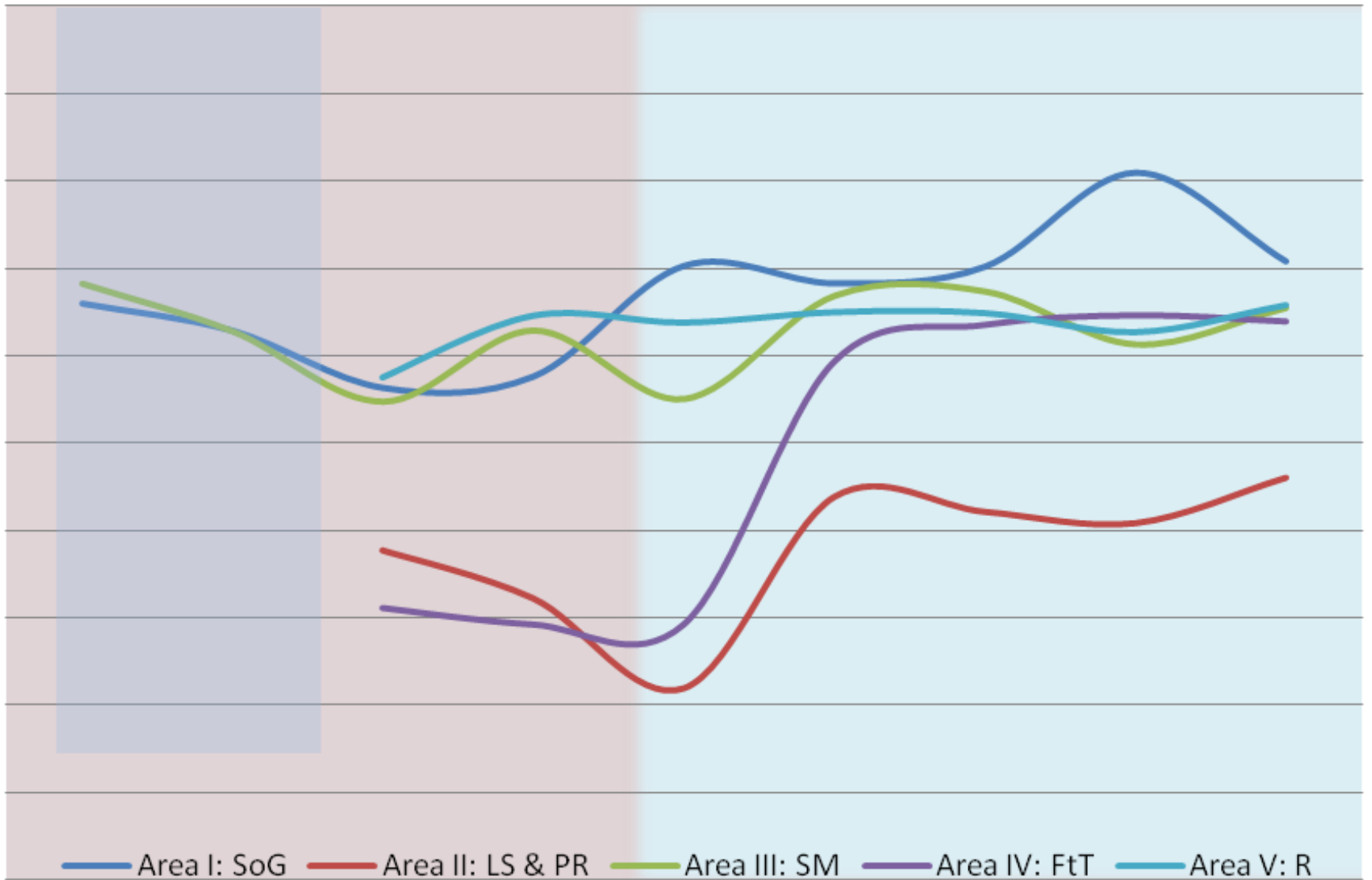
3 Results

- Impact of shifts from authoritarian to democratic political decision-making is examined with different panel datasets at 5-year time intervals during **1976-2010**.
- One period time lag btw transitions to democracy and Δ EFW area.
- Dependent variable is Δ EFW area for **5-year**, **10-year**, and **15-year** intervals following shifts to democracy.
 - Potential impact of a transition to democracy for **short**, **medium**, and **longer** time intervals.
- Three estimation methods: **county fixed effects**, (**random effects**) and **two stage least squares**.
- The re model separates stable democracies and transitions.
- All models control for period effects.

Spain (1977)



Sri Lanka (1986)



Dependent variable:	Δ EFW A3			Δ EFW A4			Δ EFW A5		
	5y	10y	15y	5y	10y	15y	5y	10y	15y
	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)
Intl. EFW score	-0.567 ***	-1.001 ***	-1.177 ***	-0.513 ***	-0.852 ***	-1.077 ***	-0.600 ***	-1.016 ***	-1.169 ***
	(-11.29)	(-16.16)	(-21.34)	(-11.21)	(-14.66)	(-21.74)	(-10.04)	(-13.36)	(-16.97)
Intl. log GDP p.c.	-1.082 ***	-1.909 ***	-1.594 ***	-0.740 ***	-0.897 **	-0.706 *	-0.348	-0.304	-0.198
	(-2.85)	(-4.11)	(-3.01)	(-3.34)	(-2.49)	(-3.37)	(-1.62)	(-1.28)	(-0.94)
Democratization	0.332 * (1.70)	0.567 * (1.79)	0.269 (1.06)	0.476 ** (2.34)	0.258 (1.10)	0.374 ** (2.15)	-0.020 (-0.23)	0.075 (0.65)	0.035 (0.33)
Unstable Regime	-0.761 ***	-0.935 **	-0.760 **	-0.027	0.251	0.297 * (1.78)	-0.031 (-0.26)	0.126 (1.01)	0.343** (2.42)
Other EFW Areas	0.641 ***	0.564 ***	0.300 **	0.075 (0.87)	0.112 (0.78)	0.056 (0.39)	0.090 * (1.83)	0.022 (0.38)	0.018 (0.26)
R ² (overall)	0.10	0.15	0.26	0.19	0.34	0.51	0.08	0.18	0.28
F statistic	19.3	53.7	75.4	32.4	99.4	177.3	19.9	49.3	68.9
N	598	498	398	570	470	370	587	487	387
Countries	100	100	100	100	100	94	100	100	100

Dependent variable:	Δ EFW A3			Δ EFW A4			Δ EFW A5		
	5y	10y	15y	5y	10y	15y	5y	10y	15y
	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)
Intl. EFW score	-0.419 ***	-0.893 ***	-1.077 ***	-0.304 ***	-0.679 ***	-1.064 ***	-0.231 ***	-0.585 ***	-0.811 ***
	(-11.59)	(-14.48)	(-9.84)	(-8.72)	(-11.14)	(-8.14)	(-7.61)	(-11.12)	(-11.95)
Intl. log GDP p.c.	-0.252 *	-0.601 *	-0.719	-0.054	-0.080	-0.706 *	-0.025	0.019	0.008
	(-1.83)	(-1.69)	(-1.01)	(-0.50)	(-0.35)	(-3.37)	(-0.53)	(0.19)	(0.04)
Democratization (iv)	1.993 **	4.725 **	6.335	1.234 *	2.763 **	5.262	0.359	0.973 *	1.395
	(2.33)	(2.17)	(1.38)	(1.90)	(2.09)	(1.28)	(1.35)	(1.83)	(1.58)
Unstable Regime	-0.683 ***	-1.016 ***	-1.381 *	-0.176	-0.009	-0.178	0.003	0.093	0.181
	(-3.12)	(-2.76)	(-1.92)	(-1.07)	(-0.03)	(-0.31)	(0.03)	(0.74)	(0.97)
Other EFW Areas	0.344 ***	0.502 ***	0.267	-0.026	0.022	0.075	0.062 **	0.046	0.058
	(3.52)	(3.23)	(1.32)	(-0.49)	(0.24)	(0.45)	(2.22)	(1.02)	(0.94)
R ² (overall)	0.17	0.28	0.34	0.24	0.35	0.34	0.11	0.20	0.26
Wald chi ²	196.9	323.4	271.8	231.9	362.9	274.9	99.3	197.9	215.5
N	598	498	398	570	470	370	587	487	387
Countries	100	100	100	100	100	94	100	100	100

4. Conclusions

- ⦿ Holding other factors constant, democratic transitions seem to enhance the conditions for economic reforms that follow the principles of economic freedom.
- ⦿ In particular, stable democratizations are associated with improved access to sound money and more freedom to trade.
- ⦿ Stable (long-term) democracies are better able to improve the security of property rights than stable authoritarian regimes.
- ⦿ We do not find a robust effect of stable democratic transitions on the size of government.
- ⦿ Unstable transitions seem to strongly impede citizens access to sound money.

Thank you for listening!

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