

The Inter-Linkages between Democracy and Per Capita GDP Growth: A Cross Country Analysis

- This study is an attempt to answer the question that captivates the minds of all political economists, “Is it polity with more political rights and civil liberties that leads to economic growth or is it the reverse phenomenon of economic growth leading to democracy that holds empirically?”
- The empirical growth literature gives no clear indication as to how democracy impacts economic growth despite having the moral high ground and as a system of governance is much superior to an authoritarian regime. That is, there is evidence of both positive and negative effects and also of no direct link in democracy and growth nexus.
- Therefore, this study an attempt resolve this controversy by putting this question in a dynamic simultaneous equation framework that combines in a system the regression in differences with regression in levels applied on a cross county data set over the period 1987-2002 for 73 developed and developing countries.
- This type of modelling not only controls for the endogeneity of the explanatory variables and the unobserved country-specific effects but also allows to analyses the impact of democracy on per capita GDP growth and the reverse causation from per capita GDP growth on political and civil freedom simultaneously.
- The findings show evidence in support of a quadratic impact of the democracy on per capita GDP growth (an inverted U relationship) that is per capita GDP is found to be increasing in democracies at low levels but after a certain moderate level of democracy this relation turns negative.
- This means that per capita GDP is increasing in democracies at low levels but after a certain moderate level of democracy, this relation turns negative. Non linear relationship is also indicated in our sub groupings' estimates. Hence at a moderate level of political and civil freedom, the positive impact of democracy on per capita growth dominates but after a certain level the rent seeking activities of interest groups and the redistributive pressures in democratic regimes dominate, depressing growth levels.
- The support of reverse causation from per capita GDP growth to political and civil freedom is found only in countries grouped as partially free and free democracies.
 Also by modelling democracy and per capita GDP growth nexus in a simultaneous equation framework, we are able not only to analyse the impact of changes in democracy level on per capita GDP growth but also the reverse causation from per capita GDP growth as an indicator of prosperity on democracy, a phenomenon that has been termed as Lipset hypothesis in literature.
 However, the study does not find any evidence in support of Lipset Hypothesis that prosperity leads to increase in propensity to experience political freedom taking all countries into consideration.