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Democracy, State Capacity, and Economic Growth

CARL HENRIK KNUTSEN *
University of Oslo, Norway

Summary. — This paper discusses how regime type and state capacity may interact in affecting economic growth. The empirical analysis finds a positive and robust effect of democracy on growth in Sub-Saharan Africa, a continent historically characterized by weak-capacity states. Furthermore, the paper identifies a robust interaction effect between democracy and state capacity on growth, both in Africa and globally; the effect of democracy on growth increases when state capacity is reduced. Democracy is estimated to have a positive effect on growth in weak-capacity states, but not in high-capacity states. Additionally, the results indicate that state capacity enhances growth only in dictatorships.

Key words — democracy, dictatorship, state capacity, economic growth, Africa

1. INTRODUCTION

Despite the widely acknowledged importance of "good institutions" for economic performance (e.g., Acemoglu, Johnson, & Robinson, 2001; Hall & Jones, 1999; Helpman, 2008; North, 1989; Rodrik, Subramanian, & Trebbi, 2004; but see Glaeser, La Porta, Lopez-de Silanes, & Shleifer, 2004), there is still much uncertainty and debate on the economic effects of more specific institutional structures and whether such effects are context-dependent. There is for example widespread skepticism in academia and policy communities regarding the suitability of democracy in poor countries with weak state capacity. Many scholars question the economic benefits of democracy in, for instance, weak-capacity African states (e.g., Chabal & Daloz, 1999; Lumumba-Kasongo, 2005). Although democracy may induce politicians to select a range of "good policies", like expanding access to education (e.g., Bueno de Mesquita, Smith, Siverson, & Morrow, 2003; Lake & Baum, 2001; Lindert, 2005), there is the question of successfully implementing these policies when state capacity is low. Hence, regime type may not matter for economic growth in weak-capacity states. Some even argue that democracy may slow growth in such contexts, as democracy presumably reduces political stability and intensifies distributional conflicts (e.g., Huntington, 1968).

In contrast with these arguments, this paper documents that the effect of democracy on growth is relatively stronger when state capacity is lower, and democracy is thus *particularly* conducive to growth in contexts like the Sub-Saharan African. Furthermore, there is no clear positive effect of state capacity on growth in relatively democratic countries. But, state capacity enhances growth in dictatorships. The main measure of state capacity used below is the Bureaucratic Quality Index from the ICRG dataset, since effective bureaucracies are crucial for the capacity of state institutions to implement public policies, but the results are robust to using quite different proxies of state capacity. One interpretation of the results is that dictatorial regimes' propensity to select "bad policies" in order to enhance personal consumption or political survival (e.g., Acemoglu & Robinson, 2006a; Bueno de Mesquita et al., 2003; Miquel, 2007; Robinson, 1998) is aggravated in contexts of weak state-institutional structures. Democracy limits the discretionary powers of rulers and channels their survival-oriented behavior toward economic policies that benefit broader masses of people, and thus the national economy. This contributes to explaining why democracy outperforms dictatorship when there are few other institutional checks on rulers' behavior.

Consider, for example, Benin and Togo. These are two countries with low state capacity but different regime types after Benin's democratization in 1990. Both are small, poor West African neighbors, with quite similar ethnic fractionalization structure, French colonial history (although Togo was first colonized by Germany), a post-colonial history of military rule (although Benin was less politically stable), and even a shared currency (the CFA). The two countries thus constitute a good controlled comparison for investigating democracy's economic effects in low-capacity states. Benin's democracy after 1990 has had several deficiencies (Magnusson, 2005). However, Benin has held relatively free and fair elections since 1990 (Lindberg, 2006), and experienced alternations of executive power. Civil liberties are also relatively well protected (Freedom House, 2008a). In Togo, long-time ruler Gnassingbe Eyadema and his supporters managed to block democratization in the early 1990s, after initially yielding for pressure to institute a multi-party system (Bratton & van de Walle, 1997). Togolese elections have been far from free and fair, courts are heavily influenced by the regime, freedom of assembly is not granted, and there is government control over the media (Freedom House, 2008b). The political divergence has been accompanied by economic divergence: Figure 1,

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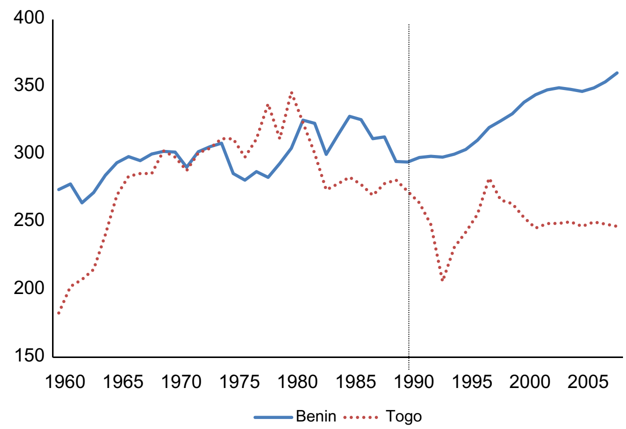

Figure 1. *Average income in Benin and Togo. This figure shows real GDP per capita (exchange rate-adjusted USD in 2000 prices) in Benin and Togo from 1960 to 2008. Source: World Development Indicators.*

showing Benin's and Togo's GDP per capita in constant US$ (measured in 2000 prices) from 1960 to 2008, illustrates how Benin has outgrown Togo after 1990.

According to World Development Indicators (WDI) data, the divergence is even clearer for PPP-adjusted income: an average Beninese was 30% wealthier than a Togolese in 1990. In 2008, however, he or she was 77% wealthier. Also other indicators point to different development paths after 1990. For example, the population-share with access to "improved sanitation facilities" in Benin increased from 12% to 30% during 1990–2006, whereas in Togo the percentage-share sank from 13 to 12. The developments in Benin are arguably related to noticeable policy-changes after democratization; for example, policies on water supply and sanitation in rural areas shifted in 1992 from more centralized programs with lacking user participation toward more effective programs based on communal participation and decentralization of decision making (World Bank, 2004). Furthermore, the educational policies pursued in post-democratization Benin are contributing to better skilled cohorts currently entering the workforce. As one recent report stated: "[T]he expansion of access to basic education in Benin is an impressive example of what can be achieved in a resource-constrained country with relatively low levels of institutional and planning capacity, if there is sufficient political support to prioritise and resource a sector" (Engel, Cossou, & Ross, 2011, p. 5). Access to education for the broad masses—i.e., the children of the majority of voters—was rapidly expanded after 1990, expenditure per student has increased, unpopular school fees have been abolished, and several less costly policies and reforms encouraging enrollment and discouraging drop-out have been pursued (see Engel et al., 2011; World Bank, 2004). Consequently, Benin's gross secondary school enrollment ratio improved from 9% to 32% during 1990–2005, whereas the primary enrollment ratio doubled from 48% to 96% according to WDI data. Is Benin's progress relative to Togo due to the former's more democratic regime? If yes, do the positive economic effects of democracy hold more generally in low-capacity states?

Below, I first discuss literatures on regime type, state capacity, and economic growth, and elaborate on potential interaction effects. I present an argument for why dictatorship is ill-suited for generating growth in weak-capacity states, with empirical illustrations from Africa. Thereafter, I conduct an empirical analysis which finds strong support for various empirical implications of the argument, for example that democracy enhances growth in Sub-Saharan Africa, a region characterized by low state capacity, and that democracy's effect on growth is higher when state capacity is lower.

2. DEMOCRACY, STATE CAPACITY, AND ECONOMIC EFFECTS

State capacity and regime type are conceptually distinct. Democracy relates to popular control over political decision making and political equality among citizens (e.g., Beetham, 1999). Free and fair elections, broad participation rights, and protection of civil liberties are crucial institutional requirements for democracy. The literature on state capacity provides different definitions (see, e.g., Hendrix, 2010), but one quite common notion is that state capacity relates to states' "ability to implement official goals, especially over the actual or potential opposition of powerful social groups" (Skocpol, 1985, p. 9). This in turn implies that independent, rule-following bureaucratic apparatuses are vital for high state capacity (e.g., Chabal & Daloz, 1999; Evans, 1995; Skocpol, 1985). Without a high-quality bureaucracy, the effective implementation of public policies in a range of areas, such as tax collection and public-services provision, is much less likely. Many scholars argue that high state capacity is crucial for economic development (e.g., Evans, 1995; Leftwich, 2000; Fukuyama, 2005), although few have tested this statistically. However, Evans and Rauch (1999) find a positive effect of "Weberian" bureaucracy on growth, using cross-section data from 35 countries. Bockstette, Chanda, and Putterman (2002), using a proxy based on historical penetration of state institutions within a territory, find that state capacity enhances growth and income levels, although the results are not robust to controlling for other institutional factors.

Degree of democracy determines who are in charge of political decision making, which in turn has implications for the shaping of economic institutions and policies. Most episodes of economic stagnation and decline globally have come in dictatorial countries (Przeworski, Alvarez, Cheibub, & Limongi, 2000), but some dictatorships, particularly in Asia after 1960, have experienced high growth. Although early statistical studies often reported negative effects of democracy on economic growth (see Przeworski & Limongi, 1993), more recent studies find either no significant, or a positive effect (e.g., Baum & Lake, 2003; Doucouliagos & Ulubasoglu, 2008; Przeworski et al., 2000).

(a) *Possible interaction effects*

Democracy's economic effects may, however, be contingent on level of state capacity, and vice versa. Seemingly plausible arguments imply that democracy and state capacity are complementary in inducing good performance. One could expect the economic benefits of democracy, related to democratic politicians' incentives to select "good policies", to be particularly substantial in high-capacity states with capabilities to successfully implement such policies (see Hanson, 2010). Conversely, democratic politicians' incentives to promote good policies may have little impact if lack of state capacity obfuscates their implementation. Hence, whether a regime is democratic or dictatorial may not matter much for growth in weak-capacity states, for example because of inefficient implementation of various public-goods projects.[1] The Africanist literature has discussed whether political competition in low-capacity states may actually lead to harmful economic policies under some circumstances (for discussions, see Englebert, 2000;