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How important is Democratic form of Political Institution for Economic Growth - Recollecting Discourses

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Abstract: This paper attempts to bring together various theoretical and empirical positions on democracy and growth nexus on one platform. Reviewing ambiguities how democracy impacts growth, we have tried to highlight rather than debate on the relative merits of autocracy or democracy for growth, a more meaningful query would be to identify what is the optimal combination of economic institutions and policies that can lead to growth and how political institutions facilitate in this process. Moreover, in the light of theoretical and empirical evidence how democratic and autocratic forms of governance relate to growth and vice versa, we argue that with development, there exists a tendency for a shift to democratic order. This can be inferred not only from empirical observation that as of now, all poor countries are autocratic or fragile democracies and rich counties are consolidated democracies but also from the emergence of various institutional mechanisms that facilitate the transition to democracy and help in countering its growth retarding tendencies.

Keywords: Economic Growth; Political Systems; Economic Institutions; Democracy; Productivity Growth

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1. Introduction

The growth theory has traditionally described output growth in terms of capital deepening, human capital accumulation and productivity growth that is in terms of resource endowments and allocative efficiency with which these resources are distributed across economic activities (Solow, 1956; Romer, 1986). However, the research in the last two decades has proved that the growth generation process is much more complex and deeper than above-listed factors. Among deeper determinants, the two candidates that have been widely proposed in the literature are geographical and institutional explanations (Engerman and Sokoloff, 1997; Acemoglu, et al. 2002). Though studies such as, Engerman and Sokoloff (1997) show that geographical constraints have influenced the institutional course in long-term development, research by institutional economists such as Acemoglu et al. (2002) and their followers including Banerjee and Iyer (2005) provides the most effective explanation of reversal in development comes through economic institutional mechanisms. Hence, for difference in growth whether long-term or contemporary, literature has consensus on primacy of economic institutions, however; question as how such institutions evolve remains. This is the interesting question that we have explored in current paper from perspective which one is more conducing to growth - democracy or autocracy as per research.

Our analysis shows that the question of how different political systems impact economic growth should not be assessed for its intrinsic value but instead for unbundling the relative relevance of political and economic institutions to growth process. The key finding from our review analysis is that inconclusive evidence on democracy and growth nexus if analyzed via explanation of impact mechanism within democracies and autocracies indicate that both these forms can result in good or bad economic policies. Hence as per findings, the focus of institutional research for pro-growth mechanism should what could be means of strengthening economic institutions and economic policy making rather than democracy versus autocracy relevance for growth. Furthermore, we found that democracies emerge naturally with development, hence; in context of political institutions relevance for growth, the focus should not how they relate to growth but on identification of factors that can enable good economic institutions to emerge within these systems and how such channels can be strengthened.

Hence, in the above perspective, the evidence that emerges from review of theoretical and empirical literature how democracy and autocracy forms relate to growth is presented in section 2. Section 3 brought forth evidence how with development, there emerges automatic institutional tendencies that facilitate both emergence as well as consolidation of democratic governments. Final section concludes by identifying important research directions for future research in light of our findings.

2. Democracy and GDP Growth Nexus

The existing scholarly work on relationship between democracy as a proxy for political institutions and GDP growth as a proxy of economic outcomes has generated contradicting findings. For example, theoretically, Wittman (1989) and Olson (1993) support growth-enhancing impact of democracies relative to autocracies while Huntington and Dominguez (1975) argue otherwise and on empirical front, too, we have evidence of both positive, negative as well as no effect of democracy on economic growth (See appendix A.1). Hence, there is no consensus in the literature how democracy may impact growth. We reviewed these contradictory findings by organizing their impact mechanism under three following views:

2.1a) Conflict View

The conflict view highlights growth retarding features of democracy and stress on prevalence of certain attributes that make democracies ineffective in promoting growth such as redistributive pressure and much more influence of interest groups. Moreover, a much higher degree of constraints in democracies may limit their power in pushing economies out of developmental trap that may require much more direct state intervention and strong ability to resist populist pressure. Few features of democracy that may limit their growth prospects are as following:

Redistributive Effect

According to the *conflict view*, there exists a tradeoff between democracy and rapid GDP growth. The first argument advocates that this negative relationship has theoretical grounds in democracy's redistributive effects where it has been reported that income distribution is not only more equal in democracies than in non-democracies but also shows improvement when switch to democracy is made (Comeau, 2003). Hence, these patterns reinforce the theoretical insight in Huntington and Dominguez (1975) that democracies reallocate national income from investment to consumption.

The theoretical basis for this confiscatory behavior in a democratic order lies in reliance on parties to gain political support of *median (or swing) voter* so as to assure one's success in an election (Downs, 1957). Since, this politically pivotal group is poorer than the voters with average income, parties may devise economic agendas keeping in mind demand for redistribution from rich to poor. Hence, given in contested elections median voter plays decisive role, one may observe reallocation of funds towards immediate consumption by ruling parties at the expense of long-run investment through much higher wages for labor class and taxation of capital for the rich (Huntington, 1968). Such policies in democracies may provide little incentive for saving and investment for capital owning class due to decline in their profit margins and may actually lead to capital flight to more profitable foreign environments reinforcing detrimental effect on growth further (Huntington & Nelson, 1976). This effect will be even more pronounced in developing countries where the gap between median voter and those in the upper-income bracket is even higher (Haggard & Kaufman, 1997).

Susceptibility to demands of interest groups

The second argument in favor of conflict view is that democratic governments make myopic decisions designed to increase their vote shares which make it more susceptible to demands of interest groups (Comeau, 2003). Such special interest politics at one level will help in organizing people with shared material interests to advance their economic preferences, but at other will use political activity to gain rents (Krueger, 1974) or enact policy which may preserve the interest of some group say wage interest of labor union by cutting into entrepreneur's profits (Gupta et al., 1998). Hence, dictatorship better insulates the state from policy gridlock from interest groups on important developmental issues, especially the ones with secure tenure. Also, dictators have an interest in furthering growth to increase their share of national income (McGuire and Olson, 1996).

Inability to take unpopular growth-oriented policies

Democracy is also believed to undermine growth through its inability to take unpopular growth-oriented policy actions. For example, cut down in current consumption to promote investment would be an unpopular policy at low levels of living typically observed in developing countries; only a dictator can make such tough but necessary decisions. On the other hand, an authoritarian regime can carry out liberalization reforms more effectively at least in initial stages when massive layoffs and cuts in entitlements follow liberalization (Fidrmuc, 2000). Hence, authoritarian regimes may be more effective in implementing developmental agendas given that they can afford the amount of discretion required in such decisions. Whereas, officials in democracies may be inherently inefficient since they have to observe much more constraints (Pettersson, 2004). However, this presumes that an autocrat behaves like *a "stationary bandit"* and choose less than total confiscation to increase welfare to his subjects with an intent to increase total output and hence, his share out of it (McGuire and Olson,1996).

Political business cycles and fiscal deficits

Another channel through which democratic regime can adversely affect an economy is through its tendencies towards an unending growth of government and fiscal deficits (Tavares and Wacziarg, 2001). Given each rational politician, in attempt to increase their vote share, has an incentive to provide their constituencies with as much infrastructure and employment as possible without putting burden of higher taxation, hence; this makes balanced budget incompatible with democratic structures. Further, practice of overspending by incumbent politicians through lax fiscal and monetary policy may be periodic and linked to run-up to election creating political rather than economic budget cycles. Such pre-electoral opportunistic behavior creates greater economic volatility undermining investment and growth in democracies (Alesina and Bayoumi, 1996).

Political Pluralism may lead to political instability

A tendency of majority voting system to legislate redistribution through land reform may empowerment of the impoverished majority can ethnic conflict, confiscation, and sometimes genocide in market-dominant minorities (World Bank, 1991; Chua, 2002). Therefore, a fractious society can be better kept intact under a stronghold of autocratic leadership under this view. Also, political pluralism and competition in a democracy can sometimes sharpen parochial and primordial loyalties as in case of Indian caste system which can also cause difficulty in adopting growth-oriented policies (Bardhan, 1993).

2.1 b) Compatibility View

According to compatibility thesis on democracy and GDP growth nexus, political and economic freedoms are mutually reinforcing as suggested in Friedman (1962). Though, there is nothing in principle that may stop non-democracies from pursuing growth-enhancing economic strategies, however; according to compatibility view, greater check on executives and transparency in democracies is believed to create economic policy that is more conducive for strengthening of economic institutions and economic rights of people than autocracies through channels described below:

Preferences of the median voter and economic consequences

Those who advocate *compatibility view* do not take democracy as threat to economic growth. According to them, the policies are restricted by the preference of the median voter in democracies. As elaborated in the words of Sen (1999), [in considering the effects of democracy relative to authoritarian regimes], we have to consider the political incentives that operate on governments and on the persons and groups that are in office. The rulers have the incentive to listen what people want if they have to face their criticism and seek their support in elections. Therefore, a democratic leader has incentive to improve wellbeing of most to ensure their re-election in contrast to a dictator who relies on narrow-clan and patronage-based support for sustainability of his power (Siegal et al. 2004). While, in principle, there is nothing that stops autocrat from taking majority's welfare into consideration, however, if he chooses not to, then; there is no mechanism to remove him except through force that may take much more time than under democratic institutions. On the other hand, the constraints in democracies via free media or through need for winning public support, make them sensitive to the needs of majority which tend to consume typically larger share of output in democracies than in autocracies (Olson, 2000). This may lead democratic governments to implement policies that are favorable to growth with encompassing interests of majority in mind.

Competition among interest groups and its influence on economic performance

Some theorist have contested the hypothesis of negative impact of interest group politics on growth in democracies by advocating their positive impact via competition that is generated between organized groups with varying policy interests. According to this perspective, the competition between the interest groups leads to the adoption of policies with positive net social benefits (Wittman, 1989), or the inefficiencies will at least be less than in autocratic regimes (Olson, 1993). Rodrik (2000) explains this concept in terms of how under uncertain electoral outcomes, competition between two interest groups in repeated interaction can lead to a compromised equilibrium which may facilitate better economic performance through reducing policy volatility. This so because both interest groups with divergent policy agendas may find it in their benefit to resolve their current distributive conflict since they may not be sure of their future relative bargaining strength via the electoral success of parties under their support. Whatever loss may come with such a concession will be covered by future benefits of concessions given by their opponents once they come in power. Also, since an autocrat mainly relies on support of his interests groups and is not accountable for his action to broader electorate; hence; he may be more susceptible to demands from such support groups (Olson, 2000).

Transparency of policy and policy-making processes

Democratic governments are marked by greater transparency of policy and policy-making processes (Wittman, 1989). The sharing of information and free media provides public a chance to monitor not just the behavior of their elected representatives but may keep check on corruption among government officials in adopting rent-seeking policies (Siegal et al. 2004; De Haan and Sturm, 2003). Also, free flow of information in and out of government creates awareness among masses about undertaken developmental policies. For example, active public-education campaign in Ugandan democratic regime dramatically reduced HIV/AIDS while suppression of information regarding SARS disease in authoritarian China allowed its spread. Finally, citizens in undemocratic countries with no free media may not have mechanisms to understand and constrain the risks taken by government. This is what had transpired in the Indonesian financial crisis where its government under dictatorial rule accumulated massive debt beyond its capacity of servicing (Goetzmann, 1999).

Better check and balance on state's expropriation

The compatibility theorists assert that authoritarian ruler have no interest in maximizing total output given they often turns political monopoly into economic monopoly with preferential treatment to its support groups compromising economic efficiency (Siegal et al. 2004). In contrast, democracies have greater property rights security because its long-term survival depends on provision and protection of civil liberty including economic freedom (Olson, 1993). Similarly, economic rights can only be secure when political and civil rights are protected as has been suggested in writing of North (1993), "[W]ell specified and enforced property rights, a necessary condition for economic growth, are only secure when political and civil rights are secure; otherwise, arbitrary confiscation is always a threat. (...) Indeed the search for efficient economic organization leads us to the political organization since it is the polity that defines and enforces the economic rules of the game." Finally, rent-seeking activities and tendencies to amass personal wealth by government officials can be controlled through accountability mechanisms such as free media and the competitive political process in democracies which may not be present in autocracies or if present may not be effective (De Haan and Sturm, 2003). Empirical evidence of strong correlation between higher investment rates and democratic governments as observed in Pastor and Sung (1995) supports above arguments as private investment is only boosted in an environment that secures property rights.

Avoidance of Extreme economic outcomes

Democracies have been observed to produce relatively less extreme results on average than autocracies; for example, calamities such as famines are better avoided in democracies (Sen, 1999). Similarly, severe economic contractions are twice as often experienced in poor autocracies in comparison with poor democracies suggesting that democracies are better equipped to prevent catastrophes (Siegal et al. 2004).

Better conflict management

Democracies render political stability by providing clear cut mechanism of succession while transitions to autocracies always involve destabilizing extralegal and coercive tactics. Development momentum is, thus; not disturbed in democratic successions apart from some specific policy shifts. Moreover, institutions for debate such as free election with active opposition and freedom of speech within democracies allows for differences among social groups to be resolved in a predictable, inclusive, and participatory manner (Rodrik, 2000). Hence, autocratic governments may suppress conflict in short run but provide no mechanism for its solution (Lundstrom, 2002). The evidence out of sub-Sahara Africa- a region with high incidence of civil conflicts supports above view given countries undergoing democratic reform were found to have experienced armed conflicts half as often as autocracies (Siegal et al. 2004).

Greater Predictability

Democracies outperform autocratic form of government as they yield long-run growth rates that are more predictable, they produce greater stability in economic performance, and they handle adverse shocks better (Quinn and Woolley, 1999; Rodrik, 2000). This can be attributed to the hypothesis that democratic structures adjust well to changing circumstances in the sense that democracies institutionalize right to change leaders or policies that go wrong; hence there is always pressure to amend, drop or replace initiatives that do not work (Siegal et al. 2004). Further, Przeworski et al. (2000) observe that autocratic polities exhibit substantial variance in economic performance within them as compared to democracies as policies in the former depend on authoritative will of dictator rather than some structured process. Their performance borders on extreme as there is found to be historical evidence of both economic miracles and disasters or both in performance of various dictatorships.

An autocrat may also create uncertainty for his subjects due to possible reversal as in words of Olson (2000) "Since an autocrat, no matter how secure and forward-looking he may be, can suffer reverses or other changes that give him a short- time horizon, the subjects in an autocracy always face some risk that their capital will be confiscated, their loans repudiated, or their coin or currency debased. The only societies where individual rights to property and contract are confidently expected to last across generations are the securely democratic societies." This element of unpredictability in dictatorial rule coupled with atmosphere of oppression has direct implication on economic performance through uncertainty and indirectly via limiting people's decision to very short time horizon with adverse consequences for per-capita welfare (Przeworski et al. 2000).

Greater market efficiency and productivity growth

Democracies may outperform autocracies in terms of their ability to generate much higher market efficiency through free flow of information, capital, and labor (North, 1990). This highlights again importance of free press and civil liberties and their role in reducing information asymmetries leading to efficient equilibrium in functional democracies. Similarly, not only democracies have reported to have higher total factor productivity growth than autocracies but have been found more successful in constraining degree of oligarchy power in its market by providing easy access to potential competitors and firms (Przeworski et al. 2000; Rivera-Batiz et al. 2002). However, lower entry barriers in democracies than dictatorship due to reduction in protection of vested interest with increased political accountability is known to be generally more growth-enhancing in sectors that are closer to technological frontier and hence in economies with advanced level of technology according to this perspective (Acemoglu et al. 2006; Aghion et al. 2008).

1.1 c) The Skeptical View

The third perspective on democracy and growth nexus concludes that it has no significant direct effect on economic growth. Those who argue for this view stress that economic growth is primarily due to economic inputs and it is the pro-growth governmental policies that matter more than regime type (Kurzman et al. 2002; Comeau, 2003). Similarly, it is uncertainty and instability that deter investment and hence growth rather than form of polity (Alberto and Perotti, 1994). Hence as per skeptical view, it is economic institutions especially those that secures property rights which actually matters for growth; and the question that which regime type better secures these rights is a mis-specified question since there exist a lot of variation even within democracies and autocracies. Also, the impact may originate from some indirect channel, and once such effects are controlled for there may not seem any robust determinate relationship between democracy and growth (Doucouliagos and Ulubasoglu, 2008). Possible links through which democracy may be impacting growth indirectly as following:

The effect through the rule of law and better governance

There exists theoretical ambiguity as to which of forms of political system - democracy or autocracy, better provides for rule of law and efficient governance. At one level, it has been suggested that autocracies may outperform democracies due to presence of less corruption given is in the interest of dictators to curb corrupt practices to strengthen their stronghold on power (Cheung, 1998). This hypothesis is very similar to theoretical concept of "*Roving and Stationary Bandits*" advocated by Olson (2000) according to which a ruler attempts to extract maximun from his subjects if his rule is on temporary basis (roving bandit) in contrast to where a ruler stays for longer duration (stationary bandit). However, view that democracy having much higher accountability of people in power via free press and strong civil society may provide for better governance and hence more growth has also been proposed in literature (Rivera-Batiz et al. 2002).

Further, how corruption impacts growth is also debatable. One can find support for both positive and negative channels of its impact with Acemoglu and Verdier (1998) advocating it as a facilitator in transactions and hence source of efficiency and Mauro, (1995) and Mo (2001) citing it as source of growth reduction through encouraging large shadow economy and less prudent macroeconomic policy. Hence, how corruption impacts growth is not evident from research. Also, there could be variation in rule of law, and thus corrupt practices within and across democratic and autocratic regimes (Polterovich and Popov, 2010).

Effect through investments in human capital

Another channel of significant indirect effect of democracy on growth that has been reported in Helliwell (1994), Barro (1996), Tavares and Wacziarg (2001), Baum and Lake (2003) and Papaioannou and Siourounis (2008) works through its effect on public policies that condition the level of human capital formation. The rigorous theoretical and empirical basis for such a relationship between democracy and investment in health and education sectors has been provided in Baum and Lake (2003). According to Baum and Lake (2003), form of regime manifests itself in growth through its implication for investments in human capital and that an increase in political competition and lowering of cost for political participation as in democracies can lead to the much higher provision of public goods. This is so because state being monopolist produces less than society's preferred outcome and exploits its market power to create rents that can be redistributed to either the holders of state power or their support groups. Hence, increase in constraints on government and political competition along with lowering of barriers to political participation results in regulated monopoly in democracies which provide much higher proportion of public goods at lower prices as compared to complete autocracies with much higher degree of monopoly power.

Two such public goods that have direct consequences for productivity of workforce is public provision of health and education. The empirical findings in Baum and Lake (2003) provide evidence of much higher investment in both these sectors in democracies than dictatorships; further investment in health and educational outcomes have been found to impact differentially on growth contingent on achieved level of wealth in a democracy whereby the former has more pronounced effect in democracies at lower level of income and the latter at higher level of development. This is because, in developing countries, people in newly empowered working class first tend to focus more on improved living conditions like safe drinking water, better residential facilities, which have a positive impact on life expectancy and other health indicators leading to their increased productivity. While human capital that is attained through enhanced skills with education, especially pertaining to advance technology, is much more accumulated in wealthier countries that in poor countries that do not have resources to produce much of such capital.

Effect through population growth

Przeworski et al. (2000) highlight another channel of the impact of regimes type through their effect on population growth. According to Przeworski et al. (2000), just focusing on variation in per capita GDP growth across autocratic and democratic form of governance may yield misleading findings since impact may not be coming through variation in output growth alone but through differed demographic patterns across these forms. According to empirical findings in Przeworski et al. (2000), per capita incomes grow faster in democracies. However, it is the lower rates of population growth in democracies in comparison with a dictatorship that is found to be leading this pattern rather than the differences in output growth across these political systems. Furthermore, contributing factor in this variation in demographics is not differences in death rates or variation in age structure of population across dictatorship and democracies. Rather it is much higher birth rates due to higher fertility in autocracies that explains this higher population growth equilibrium in dictatorships. Przeworski et al. (2000) attribute this higher fertility rate in a dictatorship as an optimal response on behalf of households to presence of much higher uncertainty and unpredictability in policies and performance in a dictatorship that induces people to have more children as an investment for old-age insurance mechanism.

The effect through consolidation

Consolidation of democracy has been measured using three criteria in literature: that is how long it remains under certain order (concept of longevity), how durable is it to shocks and crisis and finally degree of contested elections that is to what extent political parties especially ones in power honor electoral outcomes (Beetham,1994). However, concept in terms of longevity or age of regime is the most commonly used indicator partly because it is easy to measure and partly it applies to both autocracies and democracies equally since by definition there does not exist a mechanism of transfer of power within autocracies through elections and also nature of shocks which lead to transition may be different for both systems. In terms of impact of democracy on economic growth via its age, there exists ample empirical evidence which suggests that economic performance of regime whether autocratic or democratic increases with its age, however, consolidated democracies tend to perform better than autocracies of the same age (Pettersson, 2004). This is because within both orders, institutions within the state, i.e., bureaucracy, leadership, legal setup, and private individuals, will habituate themselves as age of regime increases and find efficient solutions within the prevailing order. Also, the trust of people on the existing system and in inter-personal dealings implying a higher level of social capital may increase as the system becomes more durable. However, performance may be better for democracies than autocracies since interactions of various actors in the former to negotiate effective rules and regulations, whether existing or new, will be more institutionalized (Putnam, 1993).

The theoretical premise for old democracies outperforming young ones is based on research that beneficial effects of democracy reveal themselves as it consolidates. This is so that young democracies are marked by much more uncertainty for both public and private actors. At one level government in newly democratized country has to devise policies keeping in view that system may revert back to authoritarianism (Haggard and Kaufman, 1997). This fear of collapse makes them manage with short-run priorities and may not allow them to undertake less popular but growth enhancing commitments. At another level, private agents may respond to uncertainty by not taking economic initiative that they may have taken otherwise (Pettersson, 2004).

Further, accountability mechanisms that are fundamental for viability of democracies such as open and broad-based information channeling through independent media and filtering of politicians and political parties through elections may not be well developed in new democracies (Pettersson, 2004). Similarly, political competition among interest groups with divergent priorities results in less policy volatility only if electoral process has developed to extent that none of political parties or its supporters can be sure of election outcome (Rodrik, 2000). Moreover, inefficiencies arising out of unjust political lobbying also get contained in long-standing democracies as any illegal manipulation if revealed are penalized via both court-proceedings and in results of next elections.

Finally, political business cycle is phenomenon that is more prevalent in new democracies due to lack of awareness among voters who are unable to understand periodic nature of lax fiscal and monetary policy being linked to electoral campaigns (Brender and Drazen, 2005). In consolidated democracies, voters punish politicians that indulge in such practices. Also experienced voters can distinguish between competent and incompetent administrations irrespective of misguided fiscal signals; hence such tactics of pre-electoral fiscal manipulation are not as effective in consolidated democracies as in those with less experience (Block, 2011).

1.2 Non-linear Impact of Democracy on Economic Growth

The theoretical and empirical literature on democracy and economic growth nexus gives us no clear-cut support of any of above three views and empirical evidence provides ambiguous findings on effect of democratic form of governance on growth as discussed above. To sum up, we have found that positive impact of democracies on growth mainly works through increasing efficiency owing to greater accountability and transparency while negative channels work through diversion of resources away from investment for redistribution. On the other hand, autocracies may or may not lead to growth depending on personal objectives of dictator; at one level dictatorship can provide opportunity for higher capital formation due to its ability to implement unpopular growth-enhancing policies and on the other, it can negatively impact growth through arbitrary confiscation. Hence, both democratic and autocratic forms have positive and negative features in terms of their economic impact.

Since a system may combine individual attributes of both these setups to varying degrees, this may lead to possibility of nonlinear impact. For example, countries that may lie in intermediate position of civil and political liberties being classified as partially free may reveal some dimensions which are closer to pure democracy and others that resemble pure autocracy (Collier and Levitsky, 1997). It is interaction of these attributes in semi-democratic/semi-autocratic category that will define what kind of impact an increase in political and civil rights will have on GDP growth. Hence, if we can provide an ordering of countries from pure autocracy to pure democracy, we may find that democracy impacts growth in nonlinear fashion, effect being different in countries grouped at varying levels of political liberties.

If positive functions of both democracies and autocracies dominate, then; an *inverse U relation* can be observed with intermediate level of democracy as growth maximizer as compared with well-defined alternatives of pure democratic or pure autocratic order (Barro, 1996; Comeau, 2003; Plumper and Martin, 2003). However; if the intermediate level of political rights leads to combination of all weak functions of both democracies and autocracies, then; the relationship could actually be found to be *U shaped* where pure forms of regimes due to their institutional consistency perform well compared to hybrid regime (Amable, 2004).

2. Automatic Shift Towards Democratic Form of Government with Economic Development

The theoretical basis in reverse causation from economic development to country's propensity to experience democracy lies in seminal paper of Lipset (1959) which hypothesize that prosperity stimulates democracy. According to these views, countries are likely to become more democratic if economic growth succeeds in raising their average incomes to high enough levels, and such countries with greater economic freedom with freer markets and more secure private property produce faster growth and prosperity. Moreover, this strong positive relationship between economic freedom and growth is independent of political freedom. Further, according to this theory, as wealth of a nation increases, this can have implications for either emergence or sustainability of democracy or both; in either case, economic development increases propensity for political and civil freedom in a society. According to Lipset (1959), as countries develop economically, their communities also establish skills to sustain democratic governance. A similar viewpoint is presented in

Przeworski et al. (2000), according to which democracy, once established for whatever reasons that may be independent of economic development, is more likely to survive in high-income than in poor economies.

Increase in middle class size with development

According to this view, rather than political freedom leading to prosperity, it is other way round that is as a country achieves greater development, there emerge widespread desire for more political freedom. Lipset (1959) emphasizes that with development, there is an increase in the size of educated middle class which expands receptivity to democratic process. This has implications for division of power between elite and lower class. An increase in size of middle class can cause more awareness about their rights and more organization to act in collective interest. Therefore, more ability to organize in the middle and working-class can act as threat to the elite class – the industrialist and the landlord class. This threat of revolt by masses, in which there can be loss of both physical capital and human capital essential for the running of industries, will be a loss to industrialist class (Acemoglu and Robinson, 2006). To avoid such a destabilizing situation and loss of all power, it is in interest of industrialist class that some power is transferred to masses in the form of democratic process. Similarly, capitalist development lowers power of landlord class and raises ability to organize for working and middle classes (Huber et al. 1993).

Increase in urban sector size with development

In growing capitalist societies apart from a rise in literacy rates and per capita income, a differentiated urban sector emerges, including labor, professional middle class, and an entrepreneurial business class (Lipset, 1959). The entrepreneurial business class includes small and unorganized individual enterprises that are beyond the capture of state. Also, the technological change that accompanies development empowers both the working class via use of labor processes that require much more cooperation of employees and also direct producers by giving them some autonomy. Therefore, in bargaining with these elements, the state tends to become less predatory and more rule-oriented and responsive to society's needs. Expansion of an educated middle class and an independent business entrepreneurial class produce pluralistic infrastructure and emergence of active civil society which are more difficult to monitor and control from perspective of an autocrat. Hence, structural transformation that takes place in due course of economic development makes society much more complicated for effective management through dictatorial forms of command, increasing likelihood of emergence and sustainability of democratic order.

Increase in literacy rates with development

In course of history, spread of literacy to general public besides privileged elite has played a fundamental role in political transformation across Europe (Rogowski and MacRae, 2004). Economic development, with its impact on increased educational levels, increases democratic aspirations across wide range of people from all groups of society through empowering them with skills to effectively take part in democratic process (Lipset, 1959). These skills may include having much more tolerance for opposing viewpoints and in case of disagreement, developing social consensus through democratic debate within an agreed institutional framework that may help in both processing and resolving conflict.

Increase in participation of minority groups with development

Economic development brings with it opportunities for those groups that may have been excluded from productive work force previously. This can be seen through increasing labor force participation rates of female as well as increasing demand for female education with development indicating break down of patriarchal values. This expanded participation of groups that had been kept away from marketable activities in initial phases of development itself leads to emergence of social structures that are generally more participatory and hence, more receptive to democracy (Rogowski and MacRae, 2004).

Increased urbanization with development

There exists theoretical ambiguity on effect of increased urbanization which comes about as result of development, on democracy (Barro, 1996). One hypothesis is that rural population has limited ability to organize and therefore it can be easy for dictator to suppress. Also increase in urbanization makes it easier for people to meet given poor are concentrated together both at work place and in their living quarters. Hence, dense urban population is likely to produce more organization of working class which presumably implies that urban population is harder to suppress. Hence according to above reasoning dense urban centers that come about as a result of economic development may channel masses to demand more political and civil freedom. On other hand, it can also be argued that more urban population is easier for centralized government to monitor and control and hence, facilitate much more centralized governance structure undermining democracy.

More redistribution with development

For democracy to be self-enforcing equilibrium, it is essential that democratic outcome be accepted by both electoral winner and loser. According to Prezworki et al. (2000), sustainability of democracy in terms of all groups agreeing to electoral outcomes increases with development, given that average income in affluent economies had increased to thresholds that loss to income for each individual that may arise from a conflict is more than the benefit of rebellion. Hence, it is risk aversion that motivates all parties to obey results of electoral competition in affluent societies.

3. Conclusion

In light of extensive theoretical and empirical evidence as to how democracy relate to GDP growth and vice versa, we conclude that with development there is tendency for shift to democratic order. This can be inferred not only from empirical observation that as of now all poor countries are autocratic or fragile democracies and rich counties are consolidated democracies but also from emergence of various institutional mechanisms that facilitate transition to democracy. Further since there is evidence on positive, negative and no-impact for democracies on growth and also ample examples where we have well performing autocracies and also not so well performing autocracies and similar for democracies, hence we can conclude that the question that which one - autocracy or democracy better for growth is perhaps irrelevant in overall growth discussion. Rather more meaningful query for institutions and growth linkages would be to identify what is the optimal combination of economic institutions and economic policies that can lead to growth and how political institutions facilitate in this process.

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