



Munich Business School

University of Applied Sciences

MBS Outstanding Thesis

Bachelor's Thesis

**The Impact of Democratic Consolidation on
Economic Development:
Empirical Evidence in Post-Transitioning
Economies**

Munich Business School Working Paper

2023-05

Nikolina Rajovic, B.A.

Email: nikolina.rajovic@munich-business-school.de

Munich Business School Working Paper Series, ISSN 2367-3869

This bachelor's thesis was submitted to Munich Business School in December 2023 and supervised by MBS Prof. Dr. Florian W. Bartholomae (Munich Business School) and Mister MSc. Marko Ivanovic.

Abstract

This thesis examines the effects of both democracy and democratic consolidation on the GDP per capita in 28 transition countries from 2000 to 2020. Through a panel regression analysis, the study finds compelling evidence that democratic consolidation has significant and positive effects on the economic development of post-transition countries. The baseline results suggest that an increase in the V-Dem index by one point corresponds to an average increase of 23.8% in GDP per capita. More importantly, each additional year a post-transition country spends under a democratic regime leads to an increase of 4.24% in per capita GDP, on average. The results of the study remain robust across all model specifications and to the inclusion of control variables. Additionally, the study identifies an indication of a U-shaped relationship between democratic consolidation and economic development. Overall, this thesis highlights that the promotion of democratic consolidation reinforces economic development in post-transition countries.

Table of Contents	Page
1 Introduction	6
2 Literature review	8
2.1 Theoretical framework	8
2.2 Democratization during transition.....	12
2.3 Earlier empirical results	15
3 Economic and democratic trends in post-transition economies.....	24
4 Methodology and data.....	33
4.1 Model	33
4.2 Data	35
5 Results and Discussion.....	40
6 Conclusions	48
Reference List	50
Appendix	59

Index of Tables	Page
2.1: Summary of the results from the presented literature.....	23
3.1: Democratic development in the post-transition countries, 1990 – 2020.....	24
4.1: Description of variables included in the model estimation.....	39
5.1: Results obtained from fixed effects estimations for four different model.....	41
specifications	

Index of Figures

3.1: GDP per capita and political regimes, 1990 – 2020.....	27
3.2: Evolution of democracy in post-transition countries, 1990 – 2020.....	28
3.3: Educational attainment and political regimes, 1990 – 2020.....	29
3.4: Mortality rates and political regimes, 1990 – 2020.....	30
3.5: FDI and political regimes, 1995 – 2000.....	31
3.6: CPI and political regimes, 1995 – 2020.....	32
5.1: Estimated value of democracy level and democracy consolidation effects.....	47
obtained from four different model specifications	

Index of Appendices

Table A1: Descriptive statistics	59
Table A2: Estimation results - FE vs. RE	60
Table A3: Hausman test statistics	61

Index of Abbreviations

EU – European Union

FE – Fixed Effects

RE – Random Effects

CPI – Consumer Price Index

FDI – Foreign Direct Investment

V-Dem – Varieties of Democracy

CEB – Central Europe and Baltics

SEE – Southern Eastern Europe

EEC – Eastern Europe and the Caucasus

1 Introduction

After the Cold War, a number of communist countries embarked on a transition from socialist systems characterized by a planned economy with single-party governments to market-oriented economies and multi-party systems (Kmezić, 2020; Wolf, 1999). In the 1990s, the region underwent a salient wave of democratization and adopted policies that promoted economic liberalization (Bieber, 2017; Shleifer & Treisman, 2014), which resulted in substantial economic development by the mid-2000s (Roaf et al., 2014). However, despite a common starting point after the collapse of communism, transitioning countries followed different modernization pathways. Hence, the degree of democratization (Batsaikhan & Dabrowski, 2017; Kmezić, 2016) and level of economic development (Campos & Coricelli, 2002) among countries have been heterogeneous. Following three decades of transition, the democratization trajectory of South Eastern and Eastern Europe has been eroding, reaching an all-time low in 2021 (Alizada et al., 2022; Repucci & Slipowitz, 2022). Central Asia emerged as the worst-performing region, where political degradation is complemented by economic stagflation (Matveeva, 1999). Furthermore, a steady downward trend has also been observed in Central Europe, particularly in Hungary and Poland. The cases of these two democratic frontrunners illustrate that once-stable democracies can also regress.

It is conceptualized that democracy promotes economic growth (Campos et al., 2022; Gerring et al., 2005; Kurzman et al., 2002; Persson & Tabellini, 2007; Pourgerami, 1991) and facilitates economic freedom, which in turn indirectly impacts economic development (Fidrmuc, 2003; Peev & Mueller, 2012; Pei, 1999; Piatek et al., 2013). Acemoglu et al. (2019) showed that over the long term, democracy enhances GDP per capita by 20%, while Rodrik & Wacziarg (2005) contended that transition to democracy reduces growth volatility in the short term. Gerring et al. (2005) pointed out that the growth-enhancing impact of democracy is contingent not only on the contemporary regime status but also on the country's political heritage. The longer democracy persists in the country, the greater its effect on economic development. Hence, both duration and degree of democracy are important when the democracy-development relationship is analyzed (Masaki & Van de Walle, 2014; Pettersson, 2004).

In view of the significance of democratic governance, a vast amount of literature has studied the impact of democracy on economic development (Acemoglu et al., 2019; Campos et al., 2022; Glaeser et al., 2004; Helliwell, 1994; Pettersson, 2004; Przeworski & Limongi, 1993; Tavares & Wacziarg, 2001). However, no comprehensive empirical study has been conducted in the recent period considering former transition countries. Additionally, previous studies predominately centered their analysis on the contemporary relationship between democracy and economic results, commonly neglecting the notion of democratic consolidation of transition countries. This paper seeks to address the empirical gap in the context of transition countries with the aim to empirically examine the impact of both, democracy level and democracy duration on the economic results of post-transition countries. Therefore, this thesis seeks to answer the following research question: *Do countries that were successful in maintaining the democratic status for a longer period of time, i.e. which are democratically consolidated, achieve higher levels of economic development?* It is expected that former transition countries that were able to establish consolidated democratic political regimes achieve higher levels of GDP per capita.

This thesis is structured into six chapters, beginning with the introduction as the first chapter. The second chapter provides an empirical and theoretical overview of the interrelations between political regimes and economic development, involving a discussion on the experience of former transition countries during the transition. The third chapter presents dynamics of various factors associated with economic development under autocracies and democracies. The subsequent chapter outlines the methodology, along with data used for the empirical examination. The fifth chapter investigates the relationship between consolidated democracy and economic development, which has been empirically tested using standard panel regression, followed by a summary of the analysis and discussion. This sixth chapter presents a conclusion.

2 Literature review

2.1 Theoretical framework

Discussions in the literature on the effect of democratic regimes on economic development emerged in the aftermath of global democratic adjustments in the late 1980s and the fall of communism. Leftwich (1993) emphasized that liberal democracy is not just the outcome of a particular development, contrary to Marx's assertion, but together with good governance, lays the foundation for economic prosperity. The democracy-development nexus was widely analyzed on both theoretical and empirical levels. So far, academics still have conflicting views on the compatibility of democracy and economic development. When discussing this kind of relationship, Sirowy and Inkeles (1990) presented three theoretical vantage points: the conflict perspective, the compatibility perspective, and the sceptical perspective.

Within the framework of conflict perspective, democracy is perceived as a factor that hinders the pace of economic development. As democracies prioritize political pluralism and political and civil freedoms, such political regimes provide more channels through which different interest groups can manifest their demands. Indeed, in a democracy, these groups will bargain in the interest of the public. However, these groups will do so until they have reached optimal aggregate benefit, which can oftentimes take significantly longer periods (Olson, 1982). Consequently, a divisive political environment emerges with overcrowded political agendas. From this perspective, the decision-making process, and the implementation of policies necessary for economic enhancement are rather slow and inefficient. Olson (1982) further emphasized that distributional coalitions, by interfering in economic decisions, create barriers to the adoption of technological advancements and resource allocation, thereby adversely impacting economic development in the long run. All of the mentioned places an additional burden on democratic institutions in developing countries already considered fragile (Kohli, 1993, p. 685). Therefore, an authoritarian regime could be more economically feasible, as autocrats, insulated from external pressure, can suppress political and individual freedoms for the benefit of quicker policy implementation necessary to encourage economic development (Knutsen, 2021, p. 1506).

According to the compatibility perspective, democracy actively promotes political and economic pluralism that, in conjunction, favourably impact economic development. Advocates of democracy argue that the conflicting view serves the purpose of validating the repudiation of political and individual freedoms by autocrats aiming to resist regime change (Sirowy & Inkeles, 1990). The economy requires property rights and competition, both of which are secured under democracies. These factors incentivize economic subjects to undertake new opportunities and enhance the efficiency of existing activities (Scully, 1988). This is not the case in authoritarian regimes where property rights, even if provided to a certain extent, could be seized arbitrarily at any time by the ruler (Clague et al., 1996). In addition, democracies create conditions conducive to economic development by providing people with political and economic freedoms to seek entrepreneurial opportunities and pursue individual wealth. Contrary to the conflict perspective, autocracies unconstrained by the state tend to monopolize power and embrace rent-seeking activities for self-enrichment, directly hurting economic development. Such behaviour in a democratic regime carries consequences since the political incumbents could be electorally removed from power (Baum & Lake, 2003). Moreover, Gerring et al. (2012) agree with the argument made by Olson (1982) that democratic overload might pose a burden on the institutions of the newly established democracies. However, Gerring et al. (2012) clarify that after sufficient time has passed, democratic polities become more institutionalized, and therefore, established processes more regularized, rationalized, and effective in resolving differences. For this reason, enduring democratic regimes provide a stable environment in which effective policies for economic development can be adopted. Lastly, it is also noteworthy to mention that higher GDP per capita is not necessarily an end in itself, but a means to improve living conditions and general health, offer greater educational opportunities, among others, and reduce poverty (Stiglitz, 2002).

From a sceptical perspective, the prevailing belief is that the relationship between democracy and economic development is not straightforward. Sirowy & Inkeles (1990) contend that it is crucial to consider the presence of additional factors, which could differ regardless of the state's democratic character when assessing the broader democracy-development relationship. The advocates of the sceptical perspective suggest that sustained democratic progress improves economic performance, albeit through different combinations of factors that emerged from such development (Acemoglu et al., 2019; Baum & Lake, 2003; Helliwell, 1994; Rachdi & Saidi, 2015;

Tavares & Wacziarg, 2001). Several widely debated channels through which democracy might impact economic development include institutional framework, accumulation of human capital, accumulation of physical capital, and enhancement of public choice regarding government expenditure.

There is a prevalent argument asserting the importance of effective political institutions for sustained economic progress (North, 1990; Pourgerami, 1991). Pourgerami's (1991) research posits that institutions that facilitate mass participation in decision-making and guarantee political and civil rights achieve significantly better economic performance. Contemplating this viewpoint, Pei (1999) asserts that democracies are predisposed to establish such political and economic institutions. These institutions, anchored by the rule of law, establish the rules for secured property rights and contracts, protect political and civil rights, ensure checks and balances on the government, and act as an institutional safeguard to prevent the abuse of state resources. In a similar vein, prominent economists Acemoglu and Robinson (2001) distinguish between inclusive and extractive institutions, contending that the former, in contrast to the latter, enable secured property rights and economic prosperity for the broad spectrum of society. They further argue that inclusive political institutions have more incentives to shape an inclusive economy where markets are kept free and fair. Thus, such institutions foster innovation, invest in education, and create a stable environment that allows entry of new businesses and technologies, which is essential for organic economic growth. Giuliano et al. (2013) and Alali (2022) pointed out that democratic institutions are more responsive to the needs of the majority. Therefore, they are more eager to enact reforms that benefit a large segment of society, whereas, extractive institutions repress innovation to maintain monopolies and extract resources to enrich elite groups. Consequently, those institutions create a level of playing field only for a narrow elite that operates at the expense of the broad spectrum of society (Acemoglu & Robinson, 2001) and are associated with lower income levels (Deacon, 2009).

Empirical evidence also shows that the positive impact of democracy on economic development is facilitated by the accumulation of human capital. Tavares and Wacziarg (2001) and Helliwell (1994) pointed out that democracies are more inclined to respond to the interest of society and invest in education, which in turn enhances the spread of the know-how, thus directly improving productivity. The findings from

the study by Glaeser et al. (2004) indicate that countries with greater levels of human capital achieved two times higher GDP per capita compared to those with lower levels of human capital. Additionally, beyond the improvement in educational attainment rates, Baum & Lake (2003) argue that democratic countries provide a more benevolent environment for general health than non-democratic regimes. Such favorable living conditions are conducive to labor productivity growth and improved life expectancy. Hence, those countries with a rising skilled workforce are better positioned and develop faster. Similarly, Gerring et al. (2012) argued that countries that sustained democracy as a political regime for extended periods of time have lower infant mortality rates.

Others have highlighted the significance of capital accumulation as the primary cause of economic development. One way to support the economy is to increase capital stock or more precisely, attract foreign direct investment (FDI) (Jensen, 2003). Democracies are more prone to open their economies and enable capital flows into the country (Pandya, 2014). Research by Busse (2003) showed that countries with improved political and civil rights levels experienced higher FDI inflows. Jensen (2003) argued that democracies, compared to autocracies, can attract 70% more FDI inflows. Furthermore, democracies are associated with a less turbulent political environment and attractive national policies, and as such are favored by investors who seek limited risk (Kurzman et al., 2002). Furthermore, Scully (1988) adds that secured property rights and legal claims on income contribute significantly to greater capital accumulation. On the same note, Clague et al. (1996) posited that enduring democracies provide superior property and contract rights, establishing themselves as havens for capital flights.

Another frequently proposed channel linking democracy and economic development is the level of government expenditure. While autocratic countries use the resources to support the members of the narrow elite, democracies channel spending towards public goods (Deacon, 2009). Therefore, democracies foster economic development through investments in education, health, and infrastructure, all of which provide higher returns in the long run. Also, as political incumbents can be sanctioned at the ballot box, they have stronger incentives to allocate government expenditures towards public good and pursue more developmental policies to gain the support of the majority. Deacon (2009) confirms in his study that democracies allocate twice as much to the provision of public

goods compared to non-democratic counterparts. Prioritizing public welfare, democracies also devote a lower share of total GDP to military expenditures (Deacon, 2009), reducing the burden on the government budget. However, it is also worth considering that electoral pressures on democratic governments may lead, in some cases, to over-investment as a strategy to increase prospects of re-election (Przeworski & Limongi, 1993). This, in turn, could potentially repress private investments and, consequently, impede overall economic performance (Plümper & Martin, 2003).

2.2 Democratization during transition

The dissolution of the communist regime in the 1990s supported the liberal economic ideology that non-democratic communist regimes were unsustainable in terms of overall economic development and that such regimes prevented economic progress from taking place (Leftwich, 1993). Acknowledging this paradigm shift, transition economies embarked on a path of radical political transformation that reshaped the prevailing political climate (Fidrmuc, 2003). Subsequently, the levels of political liberalization emerged as a detrimental factor for the speed and extensive economic liberalization in the region (De Melo et al., 2001). It is interesting to observe that all post-communist countries began from a fairly comparable platform, although not completely the same when it comes to economic development and initial institutional conditions but reached a vastly uneven degree of success (Roaf et al., 2014). Many countries in Central Europe, including the Baltic states, transitioned to democracy. On the other hand, the little progress achieved in some countries in Central Asia eroded in the early stages of the transition. Those countries also delayed implementing reforms designed to open their markets to international trade, diminish inflation, introduce privatization, foster competition, and reshape their communist economies (Shleifer & Treisman, 2014). As a result, intransigent liberalization laggards performed far worse and had a slower pace of recovery, and these consequences can be observed even today (Roaf et al., 2014). The incapacity to enact these reforms stemmed largely from the political commitment of institutions and the failure to expand political freedoms (De Melo et al., 2001).

Following the transition, all of the former socialist countries experienced macroeconomic destabilization. The same economic challenges applied to both progressive and lagged reformers. However, radical reformers experienced an

economic downturn only for a short period. Firstly, transition countries struggled to create trade ties beyond the communist bloc (Havrylyshyn & Van Rooden, 1998). Secondly, as foreign exchange controls were eliminated inflation skyrocketed (Hernández-Catá, 1997). Both conditions contributed to an unprecedented fall in output. Hernández-Catá (1997) argues that in the early stage of radical liberalization, the fall in output is unavoidable, but the subsequent growth and recovery are much faster. The author further explained that aggressive reformers experienced a higher output contraction in the initial stage because they eliminated inefficient state enterprises and wasteful activities, replacing them with newly restructured firms. Nevertheless, as new enterprises gradually adapted to new technologies, the output rose, becoming more profitable and offsetting the negative effects observed during the first two years of liberalization. As a result, radical reformers (Slovenia, Poland, Hungary, Czechia, and Slovakia) achieved significantly higher output levels in 1994 than at the beginning of the transition. In contrast, slow reformers (Tajikistan, Uzbekistan, Armenia, Azerbaijan, and Georgia) experienced continued output declines through 1994 (De Melo et al., 1996). Liberalization, therefore, contributed to economic development by eliminating the old enterprise sector and paving the way for new, more productive firms that yielded greater economic benefits in the medium term (Hernández-Catá, 1997). On the same note, Wolf (1999) claims that the radical reformers outperformed the lagged reformers when it comes to economic development in the subsequent period of liberalization. The study emphasized that those countries experienced significant export growth and lower inflation. Additionally, Wolf (1999) proposed that the extent of liberalization to growth resembles a well-known J-curve.

The former communist countries undertook the transition from planned to market economies, but the ambitions to transform political regimes and their institutions were in some cases absent. It is essential to highlight that Central European and Baltic countries that built a strong democratic institutional framework (Campos & Coricelli, 2002; Peev & Mueller, 2012) managed to stabilize their economies and recover faster with more persistent and successful economic policies (Balcerowicz & Gelb, 1994; Havrylyshyn & Van Rooden, 1998; Roaf et al., 2014). The research of De Melo et al. (1996) adds the importance of the duration and intensity of the liberalization for achieving sustained economic progress in terms of GDP per capita growth rates. In addition, the author noted that the political liberalization imbalance in the region is one of the explanations for divergent economic liberalization paths. On that note, North

(1990) emphasized that the poor performance of some socialist countries was mainly driven by the dysfunction of the underlying institutional framework. Therefore, the end of the Cold War has broader ramifications. Although markets are considered the center of the economy, the institutional infrastructure plays a critical role in shaping long-term economic performance. One of the most important features of the institutional framework is the political regime. The case of transition countries reveals that democracies foster economic development by designing effective policies and institutions that positively impact the economy, through some of the before mentioned channels (Fidrmuc, 2003). De Melo et al. (1996) showed that the impact of economic liberalization is cumulative, it needs to be sustained because institutional readjustments take time to materialize. Hence, the duration and the degree of liberalization are important. In the same way, it is improbable that the transition to a democratic regime would immediately unfold positive effects on the economy because building democratic institutions and eliminating those inimical to democracy does not occur “overnight” (Boese & Eberhardt, 2021, p. 5).

Each post-socialist country has undergone democratization along different paths and with varying intensity and speed. Comeau (2003) points out that the current economic performance of the country is determined by the legacy of the political regime. Over time, this experience accumulates in the form of political capital or democratic “stock”, which yields higher returns in the long run and contributes to economic development (Gerring et al., 2005; Persson & Tabellini, 2009). Emphasizing the combined impact of duration and the level of democracy, Masaki and van de Walle (2014) stressed that increasing levels of democracy over the years contribute to the greater accumulation of democratic capital, resulting in a stronger positive effect on economic performance in the current period. The opposite holds for autocratic regimes. Pettersson (2004) showed that the economic performance of autocracies deteriorates as they mature. Therefore, it is essential to highlight the concept of democratic consolidation when evaluating how democracy influences economic development, particularly when analyzing countries with diverse regime trajectories throughout history.

2.3 Earlier empirical results

The discussions on the effects of democracy on economic results have been comprehensively growing since the late 1980s. In general, numerous studies have found that democracy has a positive effect on economic development (Acemoglu & Robinson, 2001; Baum & Lake, 2003; Campos et al., 2022; Persson & Tabellini, 2009). However, despite a considerable amount of empirical and theoretical literature, the conclusions on direct association remain ambiguous, with limited empirical evidence on post-communist countries as a unique group. One of the reasons is that identifying the direct effects of democracy on economic development is not straightforward and it is difficult to measure due to the unobserved external dynamics that may affect the economic outcomes (Campos et al., 2022). Moreover, it is difficult to assess democracy and define specific components of the political system. Even when scholars agree on such characteristics, they may have opposing opinions on how to reduce the complexity of that many features into one single variable, so that they do not dilute the key elements of political regimes. Nevertheless, former communist countries received much attention in the empirical and theoretical sphere during and shortly after the transition period. Empirical studies in the context of transition were conducted with the aim to assess the performance of yet-established democracies during the simultaneous economic and political transition or to re-assess their performance shortly thereafter. However, the literature analyzing the association between democracy on economic development has fallen short in the recent decades, with no empirical evidence thus far. The re-evaluation of the relationship is of paramount importance to assess the political and economic trajectories of former transition countries for several reasons. Considering recent events there is now concern about massive de-democratization observed in consolidated, as well as in yet-established democracies. The situation reflects the great levels of instability in the region and thus has drawn the attention of numerous reports and other theoretical studies (Alizada et al., 2021, 2022; Cianetti et al., 2018; Merkel, 2019; Repucci & Slipowitz, 2022). Furthermore, structural changes of any type require longer periods of time to bear results. Thus, it is not expected that the positive effects of democracy will be the same for mature democracies and newly established ones. Some countries have a long history of democratic regime (e.g., Baltic countries), whereas, in some countries, democratization is a relatively recent concept (e.g., Moldova and Georgia). Consequently, previous studies failed to address the transition of all post-communist

countries in question, as well as to account for the effects of the democratic consolidation of early movers.

A comprehensive meta-study by Doucouliagos & Ulubaşođlu (2008) applied a quantitative approach to assess accumulated empirical evidence from 84 studies on the nexus between democracy and economic development. Findings derived from 483 regression estimates indicate that 64% of the estimates are positive, out of which only 27% are statistically significant. On the other hand, 36% of the estimates revealed negative findings, with 15% of these estimates proving statistically significant results. The reason behind these contrasting outcomes, Doucouliagos & Ulubaşođlu (2008) attributed to different approaches used to define democracy and narrow-oriented research that focused specifically on certain channels. For example, some studies focus on human capital and political instability, while others concentrate on physical investment as a mechanism linking democracy and development. Similarly, the differences in the research design (measurement of variables, econometric specifications, and estimation methodologies) or practical considerations (time periods and sample under consideration) among studies could have contributed to variations in results. Doucouliagos and Ulubaşođlu (2008), argued that the degree of the democracy-development relationship depends on regional factors. Hence, the impact of democracy in one region is stronger than in the other. Overall, the study concluded that the effects of economic freedom and market-enhancing reforms are direct and positive. The results of the research indicate that democracy has a welfare-enhancing impact on economic development through reduced inflation and political instability and economic freedom and accumulation of human capital.

Beyond the direct impact of democracy, Baum and Lake (2003) investigated the indirect effects on the subsequent economic performance of 128 countries from 1967 to 1997. Using a two-equation recursive system of regression, the study affirmed that democracy exerts positive indirect effects on economic development manifested through a positive impact on education and public health. More precisely, the results of the analysis indicate that democracy positively affects life expectancy in the 62% of the countries under observation whose GDP per capita is less than 2,500\$. In developing countries, the maximum rise in democracy raises life expectancy by roughly 9.4 years. In terms of economic development, the maximum increase in democracy spurs annual GDP per capita growth by 0.68 percentage points by

prolonging the life span. The maximum increase in democracy score reflects an increase in GDP per capita growth by 0.26 percentage points, albeit through an improved secondary enrollment ratio. In light of these findings, Baum and Lake (2003) concluded that democratic regimes provide greater levels of public services that enhance human capital, favorably affecting economic development. However, the results also highlight that this effect is non-linear and it varies between developed and developing countries. In less affluent countries, democracy demonstrates a robust and statistically significant positive impact on life expectancy and GDP per capita growth. Democracy has a strong and statistically positive impact on life expectancy and GDP per capita growth in poorer countries, but in developed countries, this effect is not statistically significant. Conversely, democracy exhibits a robust and statistically positive effect on education and GDP per capita growth in developed countries, while the same effect for developing countries is statistically insignificant.

A study conducted by Persson and Tabellini (2007) investigated the average causal effects of regime transitions on GDP per capita between 1960 and 2000, focusing on two separate events: democratic transition and autocratic transition. Employing a semi-parametric model, the study provides evidence that countries that moved away from autocracy experienced greater economic progress. The findings indicate that the growth acceleration of one percentage point translates to a 13% rise in GDP per capita by the end of the observed period. Moreover, Persson and Tabellini (2007) argued that growth effects associated with democratic transitions vary among countries, ranging from -5% to 5%, and this variance is partially linked to countries like Romania, which had fragile and weak democratic institutions. Despite the magnitude of positive effects, the study indicates that the effect is statistically insignificant. On the other hand, the political regime switch from democracy to autocracy has statistically significant negative effects on the average growth rate of GDP per capita, ranging between -1.6 and -2.4 percentage points. Thus, it can be concluded that the effects of reverse transition are more substantial. For example, the reduction of -1.8 percentage points sustained over roughly 25 years is equivalent to a 45% loss of GDP per capita by the end of the sample period. These results imply that countries opting to switch from democracy to autocracy can potentially experience significant consequences on their economies over time.

Acemoglu et al. (2019) examined the impact of democracy on GDP per capita on a panel of 175 countries between 1960 and 2010. Acemoglu et al. (2019) repudiated the popular arguments based on the modernization theory that democracy requires prior development. Using dichotomous classification, the study concludes that democratic regimes have a positive effect on economic development, both in developed and developing countries. The research found a significant positive impact on economic development by employing fixed OLS regression and controlling for GDP dynamics. Two components of the Freedom House index were used to measure democracy, namely political rights, and civil liberties. Improvements in both components increase GDP per capita by 6.65% and 10.25%, respectively. Furthermore, Acemoglu et al. (2019) stressed that a positive effect on economic development accumulates over time. After obtaining the long-run effect of permanent change in democracy, Acemoglu et al. (2019) showed that twenty-five to thirty years after democratization, countries experience higher GDP per capita by roughly 21.77%. Additionally, the research outlined several mechanisms through which democracy positively affects development, including higher investment in education and public health, reduced social unrest, encouraged economic reforms, and improved provision of public goods.

Recent research by Campos et al. (2022) concurs well with earlier results of Acemoglu et al. (2019). Contrary to the dichotomous approach applied by Acemoglu et al. (2019), Campos et al. (2022) categorized political regimes into three groups: autocracies, hybrid regimes, and democracies, and reached a similar conclusion. By analyzing 162 countries from 1960 to 2018, the study found evidence for a casual U-shaped relationship between political regimes and economic development. Compared to autocracies and democracies, “intermediate” regimes hinder GDP per capita by 20% in the long run. Campos et al. (2022) argued that this effect is driven mainly by political instability stemming from short-sighted elites focused on capturing rents in the short term and ignoring the long-term consequences of these actions. Furthermore, the research argues that the positive effects of democracy on economic progress are ten times greater than those of autocracy, regardless of the choice of democracy measurement. Campos et al. (2022) make the case that the V-Dem (Varieties of Democracy) dataset is substantially superior to the commonly used Polity dataset as it conceptually captures all the necessary components of a political system. Additionally, there are certain political costs associated with autocracies that indirectly lead to

economic costs in the long run, including clientelism, political polarization, higher corruption, and political violence. These issues are notably less observed in democracies. Campos et al. (2022) concluded that democracies provide a more stable economic environment purged from revolutions, riots, and anti-government demonstrations.

Fidrmuc (2003) investigated the relationship between democracy and economic growth in a sample of 25 post-communist countries, observing a five-year moving average set of data from 1990 and 2000. The study provides evidence that democracy reinforced progress in economic liberalization, which in turn substantially enhanced the economic success of transitioning countries. Additionally, the analysis discovered that the economic development in the early stages of the transition may have been negatively affected by democratization alone, in the absence of comparably extensive economic liberalization. This finding might be explained by the fact that there is a certain degree of uncertainty associated with the establishment of new democratic institutions and the implementation of previously unfamiliar economic policies. Given this uncertainty, market participants might pull away from profit-seeking activities, which could shock the economy in the short term. Nonetheless, as Fidrmuc (2003) points out, such a scenario became irrelevant in the subsequent stage of the transition, as consolidation of economic and political development progressed. Hence, the results of the research imply that complete liberalization of a centrally planned economy increased the country's average growth performance from 20 to 26 percentage points annually.

In the sample of 25 former transition countries, Peev & Mueller (2012) observed that nations with well-established democratic institutions experienced greater economic freedom, which had a favorable effect on the GDP per capita growth rate in the period from 1990 to 2007. Throughout the period from 1999 to 2007 countries in Central Europe and the Baltics significantly outperformed countries in Southern and Eastern Europe in terms of democracy levels, measured by the Freedom House democracy index. Comparing the average democracy range in the given period, Central Europe and the Baltics achieved scores between 2.21 and 1.91, with 1 denoting the highest level of democratic progress as determined by the study. In a comparable period, South and Eastern Europe had an average range of 6.45 and 3.72, with 7 considered as an

authoritarian regime. Unlike Southern and Eastern Europe, Central Europe and the Baltics strengthened their economic freedoms in line with democratic institutions, leading to greater growth of GDP per capita by the end of 2007. Furthermore, Peev and Mueller (2012) argued that proximity to the European Union (EU) plays a crucial role in the successful adoption of democratic institutions. The research reaches the conclusion that countries, like Slovakia which were close to Brussels, democratized successfully. On the contrary, countries that are closer to Russia struggled to successfully implement a democratic framework. Additionally, it was identified that trade freedom, monetary freedom, and freedom from corruption are the main drivers of growth. On the other hand, having been associated with larger public sectors and budget deficits, Peev & Mueller (2012) argued that democracies may also incur the cost of slower growth in GDP per capita.

When country-fixed effects were accounted for, the coefficients on the public sector and the fiscal deficit increased in size. The results implied that a 10 percentage points increase in the size of the public sector diminished annual growth by 2 percentage points, and a 1% reduction of GDP in the budget deficit improved countries' growth rate by roughly 0.8 percentage points. Nevertheless, the negative effects associated with government size and fiscal deficit are balanced by the positive effects that democracy exerts on GDP per capita through economic liberalization.

Similar results were presented by Piatek et al. (2013). The study analyzed the relationship between political and economic freedom and economic growth using the Granger causality test on a dynamic panel model for 25 post-communist countries between 1990 and 2008. In the Granger sense, the results showed that political freedom had a neutral effect on the GDP per capita growth of former transition countries. Nevertheless, Piatek et al. (2013) emphasized that democracy positively affects the rate of GDP per capita, albeit by contributing to the progress in economic liberalization throughout the entire period of transition. In addition to the favorable effects of monetary freedom and freedom from corruption reported by Peev and Mueller (2012), the study found that government spending and investment freedom are, in a Granger sense, important determinants of economic growth.

Only a limited number of studies have addressed the importance of the duration of the political regime. Scholars like Gerring et al. (2005), Masaki and van de Walle (2014),

and Pettersson (2004) observed the concept of democratic consolidation and its impact on a country's economic performance. Collectively, these studies provide evidence that the effect on GDP per capita growth is greater when democracy is considered a cumulative concept. Unlike previous research in the literature, Pettersson (2004) does not assume that the effect democracy exerts on GDP per capita is uniform across consolidated democracies and newly established ones or the same for autocratic regimes. The study investigated a direct link between regime type and GDP per capita considering the consolidation of political regimes for a global sample of 129 countries between 1961 and 2000. Before controlling for the longevity of the regime, the linear specification found evidence of a non-linear U-shaped relationship. However, once the interaction between the level of democracy and consolidation is factored in, the results of the study show that there were initial costs associated with the transition from an autocratic regime in the early stages of transition. Nonetheless, as democracy consolidates, the positive impact on GDP per capita accelerates. In the long term, democracies outperformed all other types of political regimes with a similar history of duration. Then, the marginal difference in annual growth between a fully autocratic and fully democratic state is roughly 0.37%. To illustrate the effect of consolidation, Pettersson (2004) argued that the country that remained democratic between 1960 and 2000 enhanced its GDP per capita by a factor of 1.7. If it had turned autocratic during that period, the factor would be below 0.3, resulting in a GDP per capita level of 1,000 in the year 2,000, which is 4,900 lower than it would have experienced under democracy. The findings of this study confirm the importance of maintaining a democratic political regime over an extended period for favorable economic performance.

To evaluate the long-term potential of democracy on economic growth, Gerring et al. (2005) accounted for the cumulative effects of democratic capital dating back to 1900, alongside contemporary regime levels for 180 countries. Gerring et al. (2005) criticized the commonly adopted approach to study the democracy-development nexus in the literature, which involves the use of contemporary democratic levels and its effects on the subsequent economic performance, typically considering a lag of one to four years. This study argued that the extent of the relationship depends on the regime's historical context and accumulated experience in the form of democratic stock rather than solely on the country's current regime status. According to Gerring

et al. (2005), political capital results from the accumulation of political learning and institutionalization. As democratic experience accumulates, expectations are that democracies acquire highly developed institutions that pursue better long-term policies, nurture the rule of law, and quickly resolve disagreements. Therefore, mature democracies tend to be more well-institutionalized and offer higher-quality governance. The results of the study showed that democratic stock has a positive and statistically significant impact on GDP per capita growth, and the effect is strong among late and early democratizers, irrespective of the specification of the growth equation and the inclusion of control variables. Based on the study's findings, a decade of well-established democracy is associated with an anticipated growth impact of approximately 0.7% for countries that have not been democratic in the preceding period. This means that after adjusting for cumulative impact, an improved annual growth rate of GDP per capita from 2% to 2.7% shortens the period of time needed to double income from 35 to 26 years. A further increase to 3.4% reduces the doubling time to 20.7 years. It is worth mentioning that Gerring et al. (2005) suggest that the results should be interpreted with caution given the possibility that the country's political regime a decade ago might be more important for growth today than twenty years ago and that this impact may vary from one country to another.

Masaki and van de Walle (2014) investigated the effects of democracy on growth in 43 countries in sub-Saharan Africa between 1982 and 2012. Like Pettersson (2004), the authors distinguished between the economic effects of sustained democracies and the newly transitioned democracies marked by political uncertainty that are detrimental to the growth of GDP per capita. The study employed three different model specifications: random effects, pooled effects, and fixed effects estimates. Additionally, to measure democracy levels in a given country, an ordinal measure from the Polity IV dataset was used, and the duration of democracy was measured by the number of consecutive years for which the democracy score was positive. After controlling for the country-fixed and temporal effects, the results of the analysis indicate that democratic advantage is more evident in those countries with a long history of political and civil freedom. In particular, in countries that remained democratic for over 15 years, a one-unit increase in the democracy index implies an increase in GDP per capita growth by 5.55%. The study also provides evidence that regime transitions have a negative impact on economic development. Although results

vary with different model specifications, the positive effect of the persistent democratic regime remained robust after controlling for political violence, exclusion of outliers, the inclusion of foreign aid, and different measures for economic growth.

Table 2.1: Summary of the results from the presented literature

Study	Period Observed	Country sample	Findings
Campos et al. (2022)	1960 - 2018	Global sample (162 countries)	Democracies outperform both autocracies and „intermediate” regimes, which reduce in the long run GDP per capita by about 20% percent
Acemoglu et al. (2019)	1960 - 2010	Global sample (175 countries)	Democratizations increase GDP per capita by about 20% in the long run
Masaki & van de Walle (2014)	1982 - 2012	Sub-Saharan Africa (43 countries)	The positive effects of democracy are more evident for countries that remained democratic for a longer period
Piatek et al. (2013)	1990 - 2008	Communist block (25 countries)	Democracy indirectly impacts GDP per capita growth through its positive impact on economic freedom
Peev & Mueller (2012)	1990 - 2007		
Doucouliağos & Ulubaşođlu (2008)	≈1980 - 2008	Global sample (84 studies)	Democracies exhibit lower inflation, reduced political instability, greater accumulation of human capital, and higher levels of economic freedom
Persson & Tabellini (2007)	1960 - 2000	Global sample	The average negative effect of reverse transition is –2 percentage points, equivalent to a 45% reduction a 45% reduction in GDP per capita over the period
Gerring et al. (2005)	1950 - 2000	Global sample (180 countries)	The expected GDP per capita growth impact of a decade of high-quality democracy is roughly 0.7% in countries that were not democratic in the previous period
Pettersson (2004)	1961 - 2000	Global sample (129 countries)	Democracies improve economic performance, while in autocracies, the GDP per capita growth deteriorates in the long term
Baum & Lake (2003)	1967 - 1997	Global sample (128 countries)	The effect of democracy on GDP per capita growth is primarily attributed to its indirect impact through human capital

3 Economic and democratic trends in post-transition economies

The purpose of this chapter is to present key political and economic observations in order to explain the development of post-transition countries from the starting point of the transition until 2020. The first part of this section looks at the democratic development of post-transition countries between 1990 and 2020, based on the democracy measure derived from the V-Dem dataset by Coppedge et al. (2022a). In an attempt to examine the systematic differences between autocratic and democratic regimes, in the second part of this chapter, post-transitioning countries were classified according to their regime status as of 2020, as reported by the V-Dem (2021). Then, their performance was analyzed in terms of different economic factors, namely: GDP per capita, attractiveness to FDI, mortality rates, educational attainment, and inflation.

Table 3.1: Democratic development in the post-transition countries, 1990 – 2020
(Adapted from Coppedge et al., 2022a)

Country	1990-1999	2000-2009	2010-2020	Absolute change 1990 - 2020
Central Europe and Baltics (CEB)				
Croatia	0.23	0.63	0.66	0.43
Czech Republic	0.76	0.79	0.74	-0.02
Hungary	0.73	0.72	0.49	-0.23
Estonia	0.69	0.77	0.79	0.09
Latvia	0.61	0.68	0.72	0.11
Lithuania	0.72	0.74	0.73	0.02
Poland	0.73	0.77	0.66	-0.08
Slovakia	0.41	0.73	0.71	0.30
Slovenia	0.72	0.76	0.76	0.04
<i>Average</i>	<i>0.62</i>	<i>0.73</i>	<i>0.70</i>	<i>0.07</i>
South Eastern Europe (SEE)				
Albania	0.29	0.40	0.38	0.09
Bosnia and Herzegovina	0.20	0.47	0.42	0.21
Bulgaria	0.57	0.60	0.54	-0.03
North Macedonia	0.27	0.42	0.38	0.11
Kosovo	0.17	0.31	0.39	0.37
Montenegro	0.07	0.38	0.38	0.32
Romania	0.42	0.48	0.55	0.12
Serbia	0.19	0.50	0.37	0.18
<i>Average</i>	<i>0.27</i>	<i>0.44</i>	<i>0.43</i>	<i>0.17</i>
Eastern Europe and Caucasus (EEC)				
Armenia	0.37	0.25	0.34	-0.03

Azerbaijan	0.15	0.12	0.10	-0.04
Belarus	0.34	0.16	0.16	-0.17
Moldova	0.39	0.36	0.48	0.08
Georgia	0.22	0.35	0.50	0.29
Russia	0.32	0.24	0.19	-0.14
Ukraine	0.36	0.36	0.33	-0.03
<i>Average</i>	<i>0.31</i>	<i>0.26</i>	<i>0.30</i>	<i>0.00</i>
Central Asia				
Kazakhstan	0.17	0.15	0.15	-0.02
Kyrgyzstan	0.21	0.21	0.34	0.13
Turkmenistan	0.08	0.05	0.07	-0.01
Uzbekistan	0.10	0.08	0.10	0.00
Tajikistan	0.14	0.13	0.09	-0.04
<i>Average</i>	<i>0.14</i>	<i>0.13</i>	<i>0.15</i>	<i>0.01</i>

Table 3.1 displays the average democracy scores for each of the 29 post-transition countries grouped into three sub-periods. The democracy index was constructed using an unweighted mean of five democracy indices¹ provided by the V-Dem Institute (Coppedge et al., 2022a), with values ranging from 0 (least democratic) to 1 (most democratic). As shown, the level of democratic development diverged significantly among regions. The scope of political development was significantly higher in CEB countries compared to the rest of the region, achieving an average score of 0.70 between 2010 and 2020. The democratic regime was evident from the beginning of the transition in the Baltic countries. In the subsequent periods, Estonia, Latvia, and Lithuania continued to show a positive trend, achieving an average score of 0.75 between 2010 and 2020, up from 0.67 between 1990 and 1999. Estonia emerged as the most democratic country among all post-communist countries to date. Likewise, during the period between 1990 and 1999, the Czech Republic, Slovenia, Poland, and Hungary were regarded as democratic frontrunners. However, compared to Slovenia and the Czech Republic, Poland and Hungary experienced an unprecedented decline in their average scores between 2010 and 2020, reaching the democracy level of countries in the SEE region. Significant democratic deterioration was evident in Hungary, with an average decline of -0.23 in 2010 and 2020 from the prior period. Hungary was the only country in CEB region downgraded to electoral autocracy in 2014, and it remained as such in 2020. On the other hand, the most substantial

¹ Electoral, Liberal, Participatory, Deliberative and Egalitarian Democracy Index

improvement in democratic score has been recorded in the case of Croatia, with a remarkable increase of 0.44 between 1990 and 2020.

On the other hand, the absence of any change in the average democratic score in the case of Central Asia and Eastern Europe between 1990 and 2020 indicates not only the lack of efforts to broaden democracy but also a complete reluctance to topple authoritarian rule. Apart from Georgia and Moldova, autocracy remains the prevailing political regime in the region. The democratic development in the remaining countries in these two regions has regressed. For instance, Belarus and Russia recorded the greatest decline of -0.17 and -0.14 during the observed period respectively. Despite a slight improvement observed in Kyrgyzstan, it still retains its status as an authoritarian country. However, the most concerning situation can be observed in Tajikistan and Turkmenistan, both characterized as electoral autocracies according to the latest V-Dem report (2021), and Uzbekistan as a closed autocracy throughout the entire period under observation (Alizada et al., 2021). To sum up, it can be concluded that a considerable difference existed between countries in Central Asia, EEC, and the rest of the post-transition countries when it comes to democratic development.

Furthermore, the situation in the SEE region is somewhat less gloomy compared to Central Asia and EEC. However, unlike CEB countries, countries in SEE still experience difficulties to establish stable democratic regimes. Despite slight progress in their average democracy scores since the beginning of the transition, Montenegro and Serbia continue to be labeled as electoral autocracies according to the latest V-Dem report (2022). Furthermore, the democratic levels in Serbia failed to improve over the past decade. After a significant improvement of an average of 0.31 points between 1990-1999 and 2000-2009, the average democracy score of Serbia dropped by 0.13 points, from 0.50 to 0.37 in the subsequent period. Among all SEE countries, Romania has come the closest to the levels of democratic countries in Central Europe, reaching an average score of 0.55 between 2010 and 2020. A similar could be concluded for Bulgaria, which, despite a marginal decline in the latest period, managed to maintain moderate levels of democracy up to and including the period between 2010 and 2020.

Figure 3.1: GDP per capita and political regimes, 1990 – 2020 (Adapted from World Bank, 2022c)

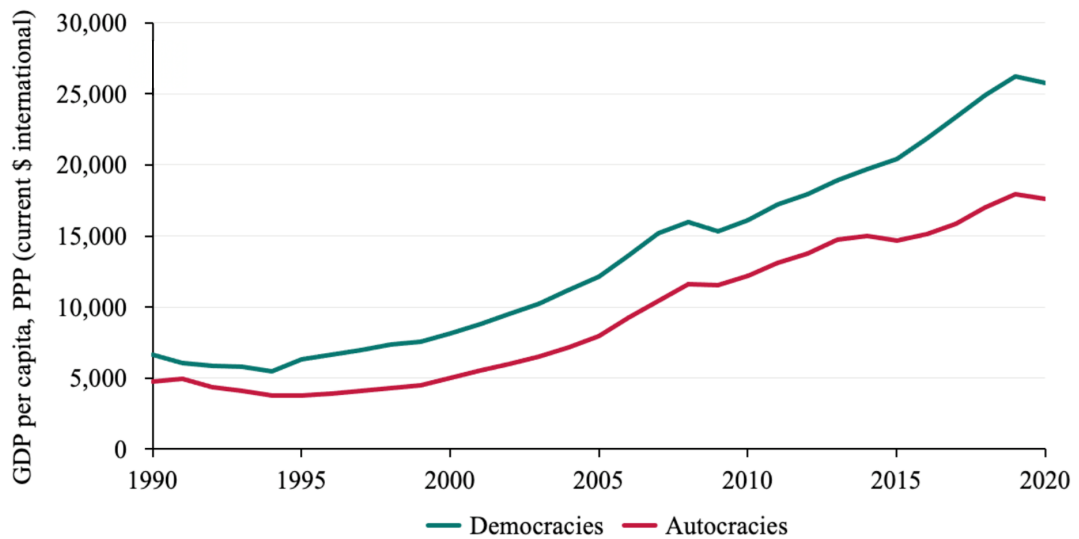


Figure 3.1 is the representation of GDP per capita dynamics in transition countries, classified according to respective regime status in 2020 into democracies and autocracies. Overall, the figure illustrates that democracies exhibited higher GDP per capita levels and have also grown at a much faster pace than autocracies. In 1990, there was an approximate GDP per capita gap of roughly 1,885 between autocratic and democratic countries. This gap significantly widened to 8,189 by 2020. During the initial four years of transition, both authoritarian and democratic countries experienced declines in GDP per capita levels. However, the decline in 1992 was more pronounced for autocratic countries, roughly 12% compared to 4% recorded in democratic countries. Nevertheless, democracies started recovering in 1995, achieving 16% GDP per capita growth from the previous year. Furthermore, although transition countries with democratic regimes were affected to a greater degree by the economic crisis in 2009, the positive trend persisted until 2019, surpassing that of autocratic nations.

Figure 3.2: Evolution of democracy in post-transition countries, 1990 – 2020
(Adapted from Coppedge et al., 2022a)

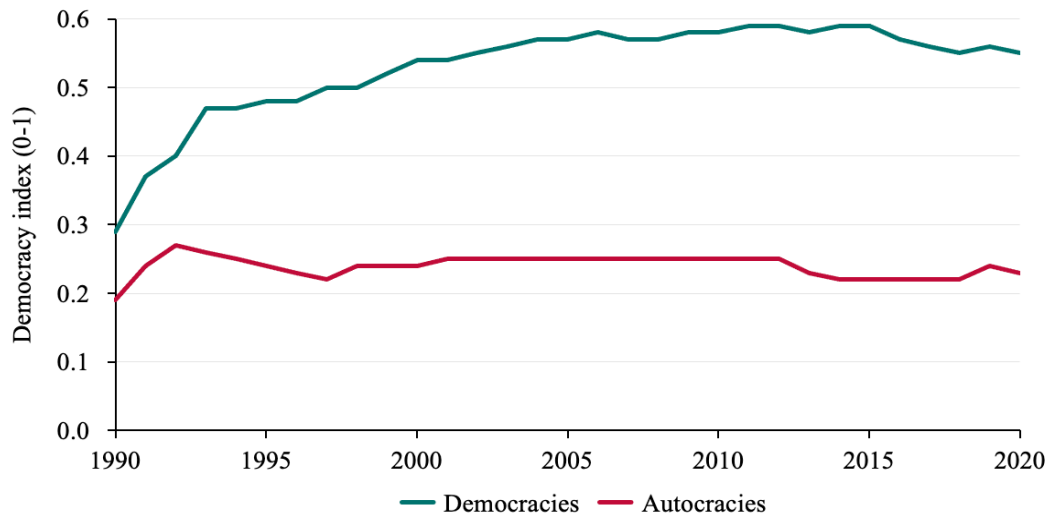


Figure 3.2 illustrates the annual changes in the democracy index of post-transition countries grouped by regime type between 1990 and 2020. The classification was made according to the regime status² in 2020 based on the V-Dem report (2021). In the very early period of the transition, both autocracies and democracies made progress towards democratization. However, after reaching a peak of 0.27 in 1992, the average democracy score of autocratic countries reverted in 1997. In contrast, the democratization efforts of democratic countries continued, which is reflected in the steep rise in the average democracy score from 0.29 in 1990 to 0.50 in 1997. What stands out in Figure 3.2 is the general positive pattern in the case of democratic countries between 1990 and 2015, which shows that some post-transition countries have succeeded in consolidating democratic systems. On the other hand, after a dramatic decline in 1997 and the short period of recovery in the 2000s that followed, autocracies have done very little to improve their political regimes. As can be seen in Figure 3.2, the average democracy score stagnated for more than a decade, followed by a decline in 2014, and moved up slightly until the end of the observed period. Furthermore, it is important to highlight the recent trend of democratic regression evident in democratic countries between 2016 and 2020. More specifically, the average democracy index has fallen from the highest point of 0.59 in 2016 to 0.54 in 2020.

² According to the report autocratic regimes in 2020 were identified in following countries: Hungary, Montenegro, Serbia, Armenia, Azerbaijan, Belarus, Russia, Kazakhstan, Kyrgyzstan, Turkmenistan, Uzbekistan and Tajikistan. The rest of the countries are democracies.

Figure 3.3: Educational attainment and political regimes, 1990 – 2020 (Adapted from Barro & Lee, 2013; Lee & Lee, 2016; Linz & Stepan, 1996)

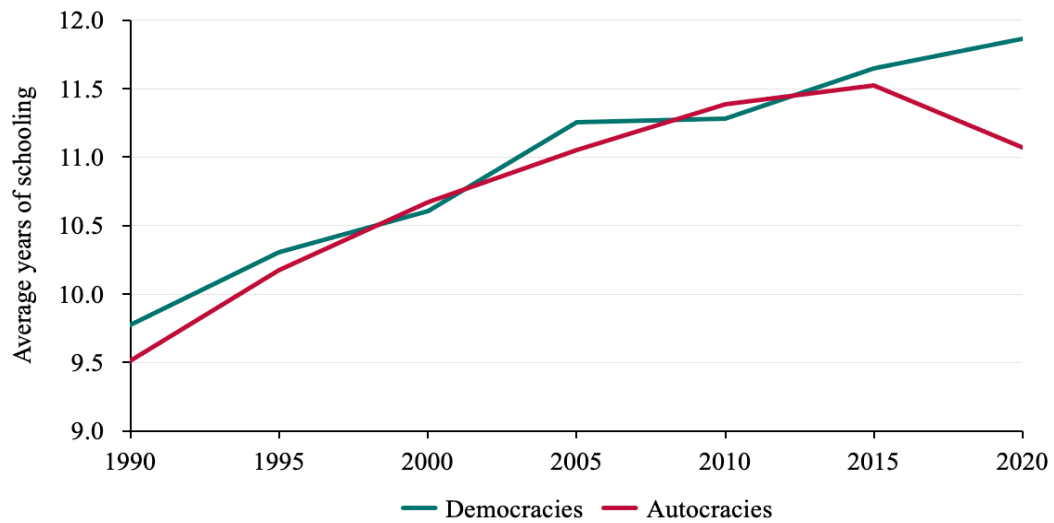


Figure 3.3 examines the fluctuation in educational attainment in autocratic and democratic systems between 1990 and 2020. Educational attainment is measured as the average years of schooling among the population above the age of 15, measured on 5-year intervals and derived from the commonly used data set in the literature by Barro and Lee (2013). Missing observations for some years in the case of countries such as Bosnia and Hercegovina, North Macedonia, Montenegro, Azerbaijan, Belarus, Georgia, Uzbekistan, and Tajikistan were sourced from Our World in Data based on Barro and Lee (2015) and Lee and Lee (2016) data sets. Furthermore, data for the year 2020 were retrieved from projections of the Wittgenstein Centre for Demography and Global Human Capital (Lutz et al., 2018). Figure 3.3 illustrates an evident variation in the trend between democratic and autocratic regimes during the period observed. Both autocratic and democratic countries experienced improvements in average years of schooling from 1990 to 1995. In 1995, the population in democratic countries had an average of 10.3 years of schooling, representing a gradual increase from roughly 9.7 years in 1990. In addition, progress was also evident in autocratic countries, with an average of 10.1 in 1995, marking an increase of roughly 0.6 years from 1990. Notably, the change of trajectory between 2000 and 2010, when autocratic countries outperformed democratic countries, was mainly driven by the lower-than-average scores of Bosnia and Hercegovina and Macedonia within the group of democratic countries. Specifically, these two countries together reported an average of 6.75 years in 2000 and 7.8 in 2010, while the group average stood at 10.7 and 11.23 in the same period. Nevertheless, countries with democratic regimes continued the positive trend

after 2010, surpassing autocracies in 2015, which experienced a steep decline from that point onward. In summary, it can be inferred that citizens of more democratic nations receive, on average, greater educational attainment than those in autocratic regimes.

Figure 3.4: Mortality rates and political regimes, 1990 – 2020 (Adapted from World Bank, 2022d)

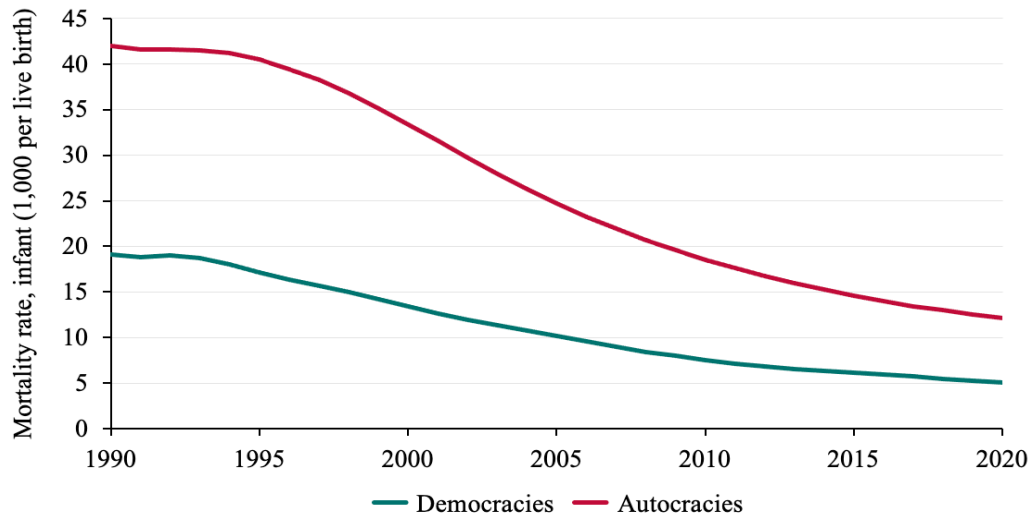


Figure 3.4 reports infant mortality rates of countries with democratic and autocratic political regimes, defined as the number of deaths within the first year of life per 1,000 live births. It is a widely used indicator for addressing the general health of a population. It is also considered one of the determinants of democracy that is likely linked to economic development. Between 1990 and 2020, mortality rates in countries with both types of political regimes have fallen substantially. Nevertheless, it is apparent in Figure 3.4 that autocratic countries had significantly higher mortality rates compared to countries that are more democratic. The average mortality rate of autocratic countries stood at 42 in 1990, which is twice as high as the rate recorded in democratic countries. By the end of 2020 average mortality rate of democratic and autocratic regimes reduced to 5 and 12, respectively. Hence, it can be concluded that democratic regimes have been more successful in reducing infant mortality.

Figure 3.5: FDI and political regimes, 1995-2000 (Adapted from World Bank, 2022b)

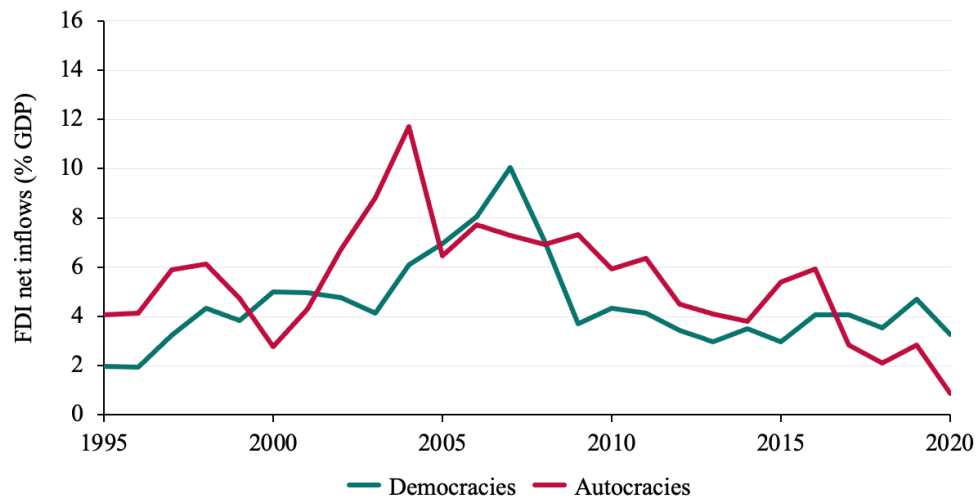


Figure 3.5 shows the difference between democratic and autocratic transition countries³ in terms of FDI net inflows measured as % of GDP during the period observed. The data does not reveal a clear and consistent pattern between these two groups of countries. For most of the observed period, the level of FDI was, on average, higher among countries classified as autocracies. FDI as a % of GDP totaled roughly 12%, compared to 6% in democracies in 2006. This implies that the ability to attract more FDI is not significantly greater in democratic countries than in autocratic countries, as it would be expected. One of the possible explanations for this is that democratic institutions do not provide opportunities for multinational enterprises to establish monopolistic or oligopolistic positions in the host market (Li & Resnick, 2003). In contrast, autocratic governments often have a higher degree of control over their economies, creating an environment in which multinational enterprises in pursuit of higher returns, can establish such positions and attain greater market power. Nevertheless, according to Jensen (2003), the appeal of autocratic countries in terms of FDI may change over time. Factors such as political and economic reforms, shifts in global economic trends, favorable locations, and evolving investor preferences can all influence FDI levels in a country. Another possible explanation proposed by Campos and Kinoshita (2003) is that counties with affordable labor and natural resources are more likely attract higher FDI flows. For example, countries rich in natural resources, such as Azerbaijan, Kazakhstan, and Russia, were among the largest

³ Given the inconsistency in data for Kosovo, Montenegro and Serbia it should be noted that the analysis excluded data of mentioned countries up to 2007. Also, the graph excluded a major outliers, such as Hungary which had FDI of -40% in 2018, 60% in 2019 and 109% in 2020.

recipients of FDI (United Nations, 2001). This implies that, in some cases, these factors might have greater influence than the nature of the institutional framework. As indicated by Figure 3.5, democratic countries had a greater degree of FDI penetration between 2003 and 2007. In the case of democratic countries, the largest recipient and driver of an upward trend in 2003 were Baltic countries, particularly Estonia. In sum, it can be concluded that FDI flows were disproportionately concentrated between democratic and autocratic countries.

Figure 3.6: CPI and political regimes, 1995 – 2020 (Adapted World Bank, 2022a)

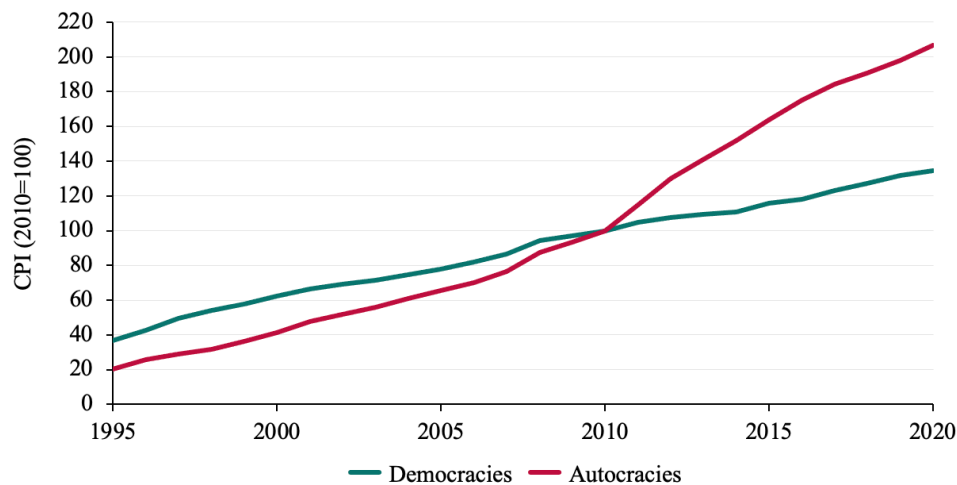


Figure 3.6 compares the inflation levels measured by the Consumer Price Index (CPI) between democratic and autocratic post-transition countries from 1995 to 2020⁴. The figure shows that democratic countries experienced higher levels of inflation until 2010. Nevertheless, starting from 2010, the rise in inflation was more pronounced in autocratic countries, reaching the value of 200 in 2020, which is 70 percentage points higher than in democracies. However, it is crucial to emphasize that a wide range of factors, such as specific policies or external shocks can influence inflation rates. Thus, the relationship between the type of political regime and inflation is not deterministic. The period from 1995 to 2010 saw significant global economic changes, and countries experienced different economic trajectories during that time. As highlighted by Christoffersen and Doyle (1988), this period coincided with a transition and countries shifting from centrally planned to market-oriented economies, experienced rising inflation due to factors such as lifted price controls, monetary policy reforms, reduced subsidies, and exchange rate adjustments. Furthermore, Hollyer et al. (2011) show that

⁴ The analysis excluded countries such as Bosnia and Herzegovina, Kosovo, Montenegro, Turkmenistan, Uzbekistan and Tajikistan given the inconsistency in data for some years.

it is not uncommon to conceal or manipulate economic indicators, including inflation in autocratic regimes. In autocracies, institutions such as central banks or statistical agencies have less independence from political leaders and lower transparency. Autocratic governments also may exert greater control over prices, particularly for essential goods and services. This control can help suppress the level of inflation, even if underlying economic pressures in the economy exist.

4 Methodology and data

4.1 Model

To evaluate the impact of both the level and duration of democracy on economic development among post-transition countries, this study adopts the methodological framework outlined by Masaki and Van de Walle (2014). The following model specification was estimated:

$$GR_{it} = \beta_0 + \beta_1 DL_{it-1} + \beta_2 DD_{it-1} + \beta_3 DC_{it-1} + \beta_4 DC_{it-1}^2 + \gamma CON_{it-1} + \varepsilon_{it} \quad (1)$$

Where:

- (1) GR_{it} is the dependent variable which refers to the GDP per capita of a country i in the period t ;
- (2) DL_{it} is the independent variable that indicates the level of democracy in country i in the period $t - 1$ measured by V-Dem index value;
- (3) Another independent variable, denoted as DD_{it} , signifies the duration of democracy in country i in the period $t - 1$;
- (4) DC_{it} is the main independent variable indicating consolidation of a democracy in country i in the period $t - 1$. It represents interaction between both the democracy level and democracy duration;
- (5) DC_{it}^2 is the independent variable that refers to the square value of democracy consolidation in a country i in the period $t - 1$;
- (6) CON_{it} is a set of control variables included in the model. These control variables encompass the initial GDP per capita, inflation, government expenditure, life expectancy, FDI, trade volume, EU membership and the share of agriculture of a country i in the period $t - 1$;
- (7) The error term of the regression, denoted as ε_{it} , accounts for unexplained variability in the regression model.

The equation (1) was estimated with the standard panel regression to examine the average impact of democracy level, its duration, and the impact of other control variables on GDP per capita among post-transition countries between 2000 and 2020. The primary focus of this estimation revolves around the values of β_1 and β_3 coefficients, which provide insights into the statistical significance and the extent of the impact exerted by the democracy level and democracy consolidation variables. The value of β_1 represents the impact of democracy on economic development when democracy duration equals zero. In other words, it measures the impact of a one-unit rise in the V-Dem index on GDP per capita, depending on the level of democratic maturity within the country. Additionally, the value of β_3 coefficients is also important for the analysis since it shows that the democratic dividend resulting from democratic consolidation is expected to be higher in those countries that managed to maintain democratic status for a longer period successfully. The main assumption is that the value of β_3 is positive, starting from the hypothesis that transition countries that have sustained democracy over the long term experience economic benefits in terms of higher GDP per capita. Furthermore, the model includes the square value of democracy consolidation, assuming that the relationship between the GDP per capita and democratic consolidation is non-linear (Campos et al., 2022; Masaki & Van de Walle, 2014).

In general, panel data models can be estimated allowing for fixed effects (FE) and random effects (RE). The FE method treats the constant (β_0) as group-specific, which means that the model allows for different constants for each group, and in this context, it refers to individual countries. The model captures all effects unique to individual countries such as geographical factors, religion, natural endowments, etc. These effects vary between countries but remain constant over time. An alternative method for estimating equation (1) is to use the RE method. The RE model treats these constants for each group, not as fixed but as random parameters. This means it assumes that the differences between countries lie in the error term, whereas the FE model assumes that each country differs in its intercept term. One challenge of the RE approach is that the researcher needs to make specific assumptions about the distribution of the random component (Asteriou & Hall, 2011).

In general, scholars in economic and political science literature prefer the FE method because the FE model remains consistent when the estimators are correlated with the

individual effect (Bell & Jones, 2015). Compared to FE, RE estimators are more susceptible to bias because the effects may not adequately account for country-specific characteristics. However, the RE model is a more appropriate choice in cases when the sample size is constrained, particularly when there are few observations for each of the cross-sectional units (Asteriou & Hall, 2011). In order to determine the appropriate model specification for equation (1), the Hausman test was performed. Proposed by Hausman (1978), the test assists in determining which of these two methods is more suitable for panel data analysis. Specifically, the specification test assesses whether the regressors are correlated with individual unobserved effects. If the Hausman test fails to reject the null hypothesis (RE is consistent and efficient), suggesting that no significant differences between the FE and the RE, then the RE is more appropriate for estimation. The value of the Hausman test statistic will be large when there is a significant difference between the estimates, indicating that the RE model should be rejected in favor of the FE model.

Furthermore, it is important to mention the potential issue of endogeneity that may arise. This issue is widely observed in the literature and arises from the fact that political regimes are endogenous to the economic landscapes of the countries. In order to mitigate the problem of the reverse causation of economic development on these endogenous factors, this paper followed the approach by Gerring et al. (2012) and Masaki and Van de Walle (2014). Therefore, all endogenous political and economic variables were lagged and as a result, it is highly improbable that GDP per capita in period t will affect democracy in period $t - 1$. However, the lagged values might still correlate with the error terms in equation (1) in a given year. Thus, this approach does not eliminate entirely the issue of endogeneity. Nevertheless, it still minimizes the bias in the assessment.

4.2 Data

The empirical analysis is based on the sample of 28 former transition countries in the period between 2000 and 2020. In the research, the former transition countries were classified, according to Hainz et al. (2019), into four regions with each region having geographical elements and political history in common:

- (1) Central Europe and Baltics (CEB): Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia;
- (2) South Eastern Europe (SEE): Albania, Bosnia and Hercegovina, Bulgaria, North Macedonia, Kosovo, Montenegro, Romania, and Serbia;
- (3) Eastern Europe and the Caucasus (EEC): Armenia, Azerbaijan, Belarus, Georgia, Moldova, Russia, Ukraine;
- (4) Central Asia: Kazakhstan, Kyrgyzstan, Turkmenistan, Uzbekistan, and Tajikistan.

The year 1990 marks the end of the communist regime and the outset of the transition process (Peev & Mueller, 2012). However, this study focused on the post-2000 period, using 2000 as a starting point for the empirical analysis. The main reason is that the year 2000 is commonly regarded as the end of transition for most countries, signifying the end of economic disruptions stemming from earlier transitional reforms. Secondly, sufficient time has passed to allow for a comprehensive examination of the democratic consolidation in those countries that embarked on the democratization path. Lastly, on the empirical side, extending the data to earlier years would substantially diminish the size of the sample⁵.

The model includes three main independent variables: the level of democracy, the duration of democracy, and the interaction between the level and duration of democracy. Previous research predominantly relied on datasets such as the Center of Systemic Peace's Polity (Gerring et al., 2012; Persson & Tabellini, 2009; Pettersson, 2004; Rodrik & Wacziarg, 2005) and Freedom House's Civil Liberties and Political Rights (Busse, 2003) indices to account for variations of country's political regime. However, Bollen and Paxton (2000) and Boese (2019) highlighted that previously mentioned indices have considerable measurement errors. Consequently, in order to measure the level of democracy this study opted for data provided by V-Dem Institute (Coppedge et al., 2022a). The choice stems from the recognition that the V-Dem index outperforms any other measure for democracy, including the widely used Polity and Freedom House indices, as previously stressed by Boese (2019). Additionally, the most recent research by Campos et al. (2022) pointed out the advantages of using the V-Dem, including its broader coverage, greater comprehensiveness, and reduced need for data manipulation. Also, the V-Dem index aggregates the variety of democracy

⁵Because of the expected difficulty in obtaining sufficient data for some countries, the sample was reduced from 29 to 28, excluding Kosovo from the analyses.

components into unified measure, comprehensively capturing all fundamental aspects of democracy, which further underlines its suitability for the analysis.

The V-Dem offers five different indices that capture the core dimensions of democracy: the electoral dimension, the participatory dimension, the egalitarian dimension, the deliberative dimension, and the liberal dimension. These indices, in turn, consist of multiple sub-components. For instance, The V-Dem electoral democracy index is constructed from a weighted average of five sub-indices measuring freedom of association, clean elections, freedom of expression, alternative sources of information, elected officials, and suffrage. These components collectively capture the notable Dahl's seven core institutions of "polyarchy" (Coppedge et al., 2022b), aligning seamlessly with the minimalist definition of democracy as asserted by Boese (2019). The liberal dimension captures the idea of protecting the rights of an individual and minorities, while the participatory dimension embodies the involvement of citizens in all political processes. Furthermore, the deliberative dimension signifies the importance of making political choices for the public benefit based on rational dialogue. Lastly, the egalitarian dimension reflects that systematic inequalities in political rights and resources hinder political participation, advocating for a more equitable distribution of resources and rights across social groups to strengthen democracy. Each of these indices is calculated based on the range of indicators, involving the input of over 3,700 country specialists who perform the regular assessments. The data is collected through a combination of sources, including surveys, expert assessments, and administrative data (Coppedge et al., 2022b).

Furthermore, in contrast to earlier research that often defined democracy in a binary manner, contemporary economic and political scientists have shifted away from such an approach, favoring continuous measures of democracy. The use of continuous measure allows for greater data volatility, results in more precise estimation, and enables more meaningful interpretation. This approach acknowledges that regimes are not at the end of the political spectrum; rather, they can fall between autocratic and democratic regimes (Campos et al., 2022). Given the advantages of the V-Dem dataset mentioned above and its suitability for continuous measurement, this study employed data from the V-Dem institute to assess the level of democracy. For the purpose of the analysis, the unweighted average of all five indices mentioned above was used,

capturing the multifaceted nature of the democratic concept. The degree of democracy in the country was assessed by assigning a score on a scale from 0 to 1 for a particular year. Then, as suggested by Campos et al. (2022), the threshold value of 0.467 was applied in order to differentiate between democratic and autocratic regimes. In the next step, countries with V-Dem index values above 0.467 were categorized as democracies, and countries below this value were categorized as autocracies. Additionally, in order to construct the democracy consolidation variable, the scores that the country received for each consecutive year that it maintained its democratic status were added.

Turning to the factors influencing the economic development of a country, this study employed the most recent data sourced from the World Development Indicators (World Bank, 2022). To examine the economic development, the focus was placed on GDP per capita measured in current US dollars. In addition, the study incorporated six control variables derived from the same source: inflation, government expenditure, FDI, trade, life expectancy, and share of agriculture. The model includes inflation and government expenditures to control for adjustments in the overall price level. This is necessary because the GDP per capita is based on nominal value. Additionally, these variables also help to control for the size of government spending within the country (Mitchell, 2005). Furthermore, the model includes FDI and trade variables in order to control for changes in GDP associated with the impact of activities typical for an open economy. Next, to control for other pertinent political and economic factors that might potentially affect economic development, the model includes a dummy variable indicating the country's EU membership status and the share of agriculture referring to the economic structure of a country. The reason to include the dummy for the EU membership is that countries that are members of the EU might have more favorable conditions that can potentially affect the GDP per capita levels, arising from political and economic ties between member states (De Melo et al., 2001; Rapacki & Prochniak, 2019). Finally, the model also includes the share of agriculture in order to explain potential differences in the economic structure of the countries (Gylfason, 2000). A more detailed overview of the data that were used in the analysis can be found in the Table 4.1.

Table 4.1: Description of variables included in the model estimation.

Variable	Description	Source
lnGDPpc	Logarithmic value of the GDP per capita	World Development Indicators
Democracy	Democracy level measured by V-Dem index value, measured on the scale 0-1	V-Dem Institute Coppedge et al. (2022a)
DemocracyDuration	Number of consecutive years for which the V-Dem index is higher than 0.467, indicating that a country is democracy	V-Dem Institute Coppedge et al. (2022a)
DemocracyConsolidation	Interaction variable between democracy and democracy duration – equals to the product of these two variables	V-Dem Institute Coppedge et al. (2022a)
DemocracyConsolidation2	Squared value of DemocracyConsolidation variable	V-Dem Institute Coppedge et al. (2022a)
InitialGDPpc	GDP per capita in 2000	World Development Indicators
Inflation	CPI	World Development Indicators
GovernmentExpenditure	Government spending (% of GDP)	World Development Indicators
FDI	FDI, net inflows (% GDP)	World Development Indicators
Trade	Trade openness expressed as sum of a country's exports and imports relative to GDP (% GDP)	World Development Indicators
LifeExpectancy	Life expectancy	World Development Indicators
EU	Dummy variable - 1 if a country is an EU member; 0 otherwise	Eurostat
AgricultureShare	Agriculture, forestry, and fishing (% GDP)	World Development Indicators

Table A1 in the Appendix reports the descriptive statistics for all variables included in the model. It provides an overview of the number of observations, minimum, maximum, and mean values for each variable. For instance, the mean value of the democracy variable is 0.486, with a standard deviation of 0.237, while the mean value of the democracy consolidation variable equals 2.913, with a standard deviation of 4.310.

5 Results and Discussion

Table 5.1 reports the estimation results obtained by assessing the regression equation (1). The table provides the results of four different model specifications run to test for robustness. The initial model estimates the effect of democracy level on GDP per capita and includes inflation, government expenditure, life expectancy, FDI, Initial GDP per capita and trade as control variables. The second model steps further to analyze the effects of both democracy level and duration, reflecting the process of democratic consolidation on countries' economic development. The third model introduces the square term of democracy consolidation to check for nonlinearity. Both models comprise the same set of control variables included in the initial model. Lastly, the fourth specification represents the baseline model, which evaluates the impact of democratic consolidation on economic development. This model introduces two additional variables, a dummy variable for EU membership and the share of agriculture in a country's economic structure.

All four model specifications were evaluated using both FE and RE methods, followed by the application of the Hausman test to determine which estimation method is more appropriate. In all four models, the Hausman test statistics consistently proved FE method as more suitable. This indicates that the results captured effects specific to a particular country in the sample and these effects do not vary over time. In addition, taking into consideration that the panel is well-balanced, the expectation is that FE model would be more appropriate (Asteriou & Hall, 2011). The full estimations obtained by FE and RE models, along with Hausman test results, are reported in Table A3 in the Appendix. In general, robust standard errors are applied in the panel data analysis because idiosyncratic errors can exhibit heteroskedasticity, autocorrelation, or a combination of both. Thus, in order to obtain the unbiased coefficients in the estimated regression the study followed this approach and employed the robust standard errors. The detailed results of all four model specifications are represented in Table 5.1.

Table 5.1: Results obtained from fixed effects estimations for four different model specifications

	Model 1	Model 2	Model 3	Model 4
Independent variable	lnGDPpc	lnGDPpc	lnGDPpc	lnGDPpc
Dependent variable				
Democracy	0.355** (0.102)	0.281** (0.104)	0.248** (0.118)	0.238** (0.103)
Democracyduration		0.0380*** (0.00746)	0.0360*** (0.00820)	0.0321*** (0.00703)
Democracyconsolidation		0.0588*** (0.0116)	0.0549*** (0.0177)	0.0424*** (0.0153)
DemocracyconsolidationSq			-0.000350*** (0.000568)	-0.000999** (0.000479)
InitialGDPpc	0.168** (0.0257)	0.147** (0.0433)	0.114*** (0.0781)	0.101*** (0.0777)
Inflation	-0.00203*** (0.000693)	-0.00169** (0.000677)	-0.00185*** (0.000677)	-0.00122** (0.000571)
Governmentexpenditures	-0.0214*** (0.00363)	-0.0229*** (0.00351)	-0.0201*** (0.00361)	-0.0268*** (0.00298)
Lifexpectancy	0.111*** (0.00377)	0.115*** (0.00434)	0.116*** (0.00439)	0.0732*** (0.00407)
FDI	0.000445 (0.000800)	0.000776 (0.000781)	0.000471 (0.000785)	4.66e-05 (0.000660)
Trade	0.000703*** (0.000364)	0.002113*** (0.000391)	0.00108** (0.000418)	0.000959*** (0.000357)
EU				0.0205** (0.0572)
Agricultureshare				-0.0317*** (0.00222)
Constant	0.644** (0.289)	0.365** (0.333)	0.138** (0.347)	0.844* (0.466)
Observations	560	563	560	560
R-squared	0.702	0.716	0.718	0.794
Number of CountryID	28	28	28	28

Notes:

- (1) *, **, *** - Statistically significant impact at 1%, 5% and 10 % significance level, respectively;
- (2) Robust standard errors in parenthesis.

The results from the first model specification reveal that, on average, a one-point increase in the V-Dem index corresponds to a 35.5% rise in the GDP per capita among post-transition countries, considering everything else being equal. This estimated effect is relatively high compared to the effects of other variables included in the model, which suggests that economic results highly depend on political regimes. The effects of most control variables included in the model are statistically significant and with the expected sign. The sole exception is the effect of FDI, which is not statistically significant. This result aligns with the finding in the previous chapter of the paper, where it was shown that the difference between autocratic and democratic former transition countries in terms of the FDI cannot be clearly established. Furthermore, the results suggest a negative impact of inflation and government expenditure, while life expectancy and trade demonstrate a positive impact on economic development in terms of the GDP per capita. Specifically, the results indicate that a one-unit increase in the CPI index results in the reduction of the GDP per capita by 0.203% on average. Additionally, the increase in government spending as a share of GDP by one unit diminishes GDP per capita on average by 2.14%. On the other hand, the first model specification demonstrates that a one-unit increase in life expectancy results in an acceleration of 11.1% in the GDP per capita, on average. The effect of trade on the GDP per capita is relatively modest, as the estimated value suggests that an increase in the trade openness index by one unit accelerates GDP per capita by only 0.07%. Lastly, the impact of the initial GDP per capita level is statistically significant and positive, with an estimated value of the coefficient of 0.168, implying that the higher initial GDP per capita levels are associated with higher subsequent GDP per capita.

The results obtained after including democracy duration and the interaction between the level and duration of democracy in the estimation, remain stable. The second model specification indicates that the impact of democracy level and duration is statistically significant and positive. However, as Masaki and Van de Walle (2014) suggested, it is important to approach the interpretation of the estimated coefficients with caution, primarily due to the existence of the interaction term involving both the level and duration of democracy, i.e., democratic consolidation. The findings from the second model indicate that an increase in the V-Dem index by one point is anticipated to result in an average 38.1% increase in the GDP per capita when the given country has not been democratic in the preceding year, (i.e., democracy duration equals zero). More

importantly, the results suggest that the impact of democratic consolidation on economic development is both statistically significant and positive. According to the second model specification, each additional year a post-country spends in a democratic regime leads, on average, to acceleration of the GDP per capita by 5.88%. The results support the notion that the democratic dividend is more pronounced in those countries in which the democratic institutional framework has been sustained for longer periods of time (Campos et al., 2022; Masaki & Van de Walle, 2014; Pettersson, 2004). The impact of control variables included in the second model, initial GDP per capita, inflation, government expenditure, life expectancy, and trade openness, remained statistically significant with the expected sign.

The third model specification includes the square term of democracy consolidation to check for nonlinearity. The sign of the estimated coefficient for the square value of democratic consolidation is negative, implying that the relationship between democratic consolidation and GDP per capita is convex. This suggests that as a country becomes more democratically consolidated, the positive effects of democratic consolidation on economic development diminish. This result confirms the previously established U-shaped relationship between the political regime and economic outcomes (Campos et al., 2022). Barro (1996) suggested that the positive impact of democracy on GDP per capita diminishes when a moderate level of political freedom has already been attained. In the context of emerging democracies, the impact of an extra year of robust democratic practices seems to carry greater weight than it does for long-standing democratic political regimes. The positive effect of democratic consolidation also remains statistically significant, with the estimated value of the coefficient of 0.0549. The impact of control variables included in the third model remains stable as previously estimated in the first and the second model. The impact of government consumption and inflation is statistically significant and negative, and the impact of life expectancy and trade are statistically significant and positive.

Compared to the previously estimated models, the fourth model represents the complete model specification and the baseline model. The baseline specification includes the effects of both democracy level and democratic consolidation, with the square term of democracy consolidation and an extended set of control variables. The impact of the democracy level remains positive and statistically significant, with a one-

point increase in the V-Dem index resulting in an increase of GDP per capita of 23.8%, on average. It is worth noting that the magnitude of the effect is lower compared to that of the first model, which did not include the democracy consolidation variable. The results suggest that each additional year a post-transition country spends in the democratic regime raises GDP per capita, on average, by 4.24%. The effect of the square value of democratic consolidation is negative. This implies that the relationship between democratic consolidation and economic development is convex. Furthermore, the impact of most control variables included in the fourth model is statistically significant and with the expected sign. The results confirm the negative effects of inflation and government expenditure, as well as the positive effects of life expectancy and trade on economic development in terms of the GDP per capita. Additionally, the results indicate that an increase in CPI by one unit reduces the GDP per capita by 0.122%, on average. Similarly, an increase in government spending as a share of GDP by one unit leads to a reduction of 2.68% in GDP per capita among the countries in the sample. The fourth model specification also implies that an increase in life expectancy by one unit produces an increase of 7.32% in the GDP per capita, on average. However, the effect of trade on the GDP per capita remains negligible. The estimated value suggests that a one-unit increase in the trade openness index leads to an increase of 0.095%. Additionally, the impact of FDI is not statistically significant, while the effect of the initial GDP per capita level is statistically significant and positive with the estimated value of the coefficient of 0.101. Furthermore, the analysis revealed that being a member of the EU produces an increase GDP per capita by approximately 2% on average. Lastly, a one percentage point increase in the agricultural sector's contribution to the GDP leads to an average decrease of GDP per capita by 3.2%.

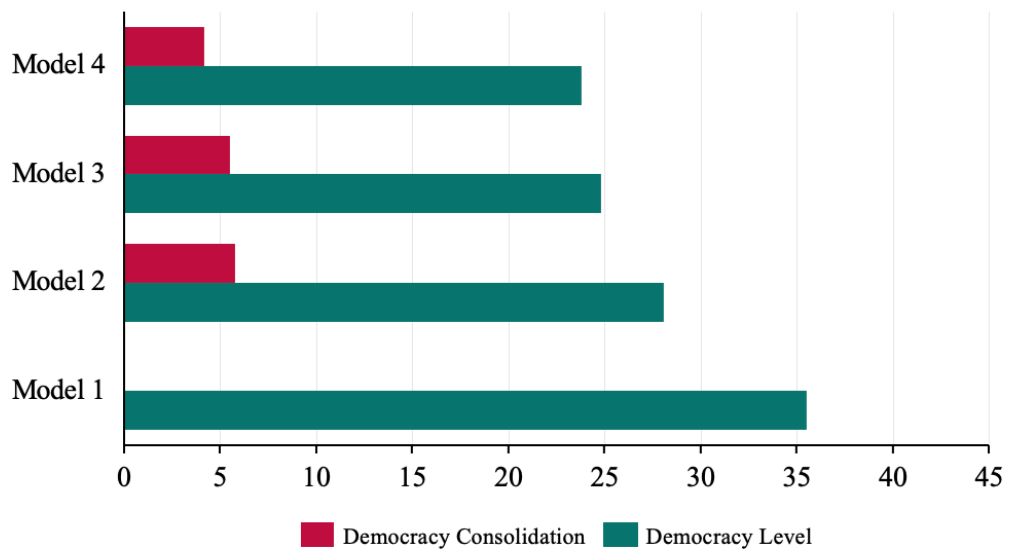
The effects of democracy on economic development in transition countries have not yet been explicitly studied. However, as outlined in the previous chapters of the thesis, there are strong theoretical bases that support the causal relationship between democratic consolidation and economic development, particularly in the context of transition countries. The results of the fourth specification align with the findings of similar studies that explored the value of democratic dividend. Masaki and Van de Walle (2014) investigated the effects of democracy on GDP per capita growth in sub-Saharan Africa, a region that, like post-transition countries, underwent significant

political regime changes. The study presented compelling evidence that a one-point increase in the Polity score leads, on average, to an increase in GDP per capita growth of 5.55%. Similarly, evidence supporting the notion that democracy raises GDP per capita was presented by Acemoglu (2019). Based on dynamic panel regression and accounting for country-fixed effects, the study found that democratic consolidation enhances GDP per capita by roughly 20% over time. A recent study by Pelke (2023) analyzed global panel data from 1789 to 2019, using V-Dem and GDP per capita data to re-examine the long-term impact of democracy on economic development. Consistent with the results of this study, the findings showed that democracy exerts a positive average impact on GDP per capita, around 17% over the long run. Building on these insights, Gerring et al. (2005) emphasized that country's economic development is a function of the total years that a country spends in a democratic regime, disregarding any authoritarian interruptions. The research showed a robust relationship between democracy stock and economic development, suggesting that a country's historical experience with a political regime plays a contributing role in the long-run economic development. The importance of these findings is particularly relevant to post-transition countries, especially for Eastern European countries. These countries struggled to establish democratic regimes in the early years of transition and, as a result, experienced more significant economic challenges. Furthermore, the rapid institutionalization of formal democracies in the post-transition countries is also facilitated by external circumstances, particularly the European integration process that offered a proper policy framework where political conditionality and economic incentives were used to promote the establishment of democratic regimes (Wolf, 1999). According to the IMF report (2014), the transition period witnessed significant alignment with Western Europe. The finding from the report indicates that income per capita increased from approximately 30% of the EU15 levels in the mid-1990s to about 50% in 2014. However, this overall average masks substantial disparities among countries, with notable progress recorded in regions like the Baltics, while countries such as Moldova and Ukraine were left behind. This suggests democratic consolidation can be a contributing factor in explaining economic divergence between post-transition countries today. Post-transition countries that established democratic political regimes from the outset of the transition and were also successful in maintaining them for extended periods outperformed those that failed to do so.

Although, the empirical results verified the proposed hypothesis, it is important to acknowledge some potential limitations of the study. One of the important limitations of the study is the challenge to establish the causal relationship between democracy and economic development. While it is expected that democratic countries have higher levels of GDP per capita some scholars argue that the causality could be reversed, with economic development impacting the income levels, education, and FDI, thus increasing the likelihood of establishing democratic governance. This concept was initially introduced by Lipset (1959). Since Lipset's work, many scholars (Burkhart & Lewis-Beck, 1994; Huber et al., 1993; Murtin & Wacziarg, 2014; Treisman, 2020) tried to show that economic development leads to democratization. This idea is closely related to the endogeneity issue, as there may be other factors that simultaneously influence both democratic and economic development and failure to adequately address this can lead to biased estimates. This paper tried to address the endogeneity problem using an appropriate econometric approach. Another common approach used in the literature, on which this paper relied to overcome such empirical limitation, is to include lagged variables. Moreover, there is another potential empirical issue related to the omitted variables, which occurs when the model does not include one or more relevant variables (Asteriou & Hall, 2011). The study followed the standard procedure to test the robustness of the results using alternative model specifications and it included a different set of control variables. However, it could be expected that there are some unobserved country characteristics or other variables not included in the model that can impact both democratic consolidation and economic development, and failure to account for these omitted variables can lead to biased estimates (Acemoglu, et al., 2019). Lastly, an aspect not addressed by the study includes the potential for autocratic regimes to fabricate data, and thus significantly exaggerate their economic performances. It was noted by Havrylyshyn and Van Rooden (1998) that some countries underreported and some overreported the figures during the transition period. Notwithstanding these limitations, the results of the study imply that considering a country's historical exposure to a democratic regime, along with the present level, has a favorable influence on economic progress. The results remained robust in all four model specifications. Figure 5.1 shows the estimated values of β_1 and β_3 coefficients, which represent the impact of democracy level and democracy consolidation on GDP per capita. These values were derived from different panel regression specifications assessed in the paper. As expected, the estimated coefficients decrease with the

inclusion of a greater number of explanatory variables in the model. However, the decline is not notably significant, and the results remained stable. Considering the impact of the democracy consolidation, the estimated coefficient decreases from 0.0588 in the second specification to 0.0424 in the fourth specification.

Figure 5.1: Estimated value of democracy level and democracy consolidation effects obtained from four different model specifications



6 Conclusions

The example of the post-transition countries after the 1990s marked not just a shift towards a market economy but also a profound political transformation, which continues to shape the narrative of post-communist development. Following the collapse of the communist legacy, economic restructuring was implemented across all countries in the early years of transition, accompanied by political changes aimed at establishing democracy in a significant number of them. More than thirty years have passed since the transition phase ended, signifying sufficient time for the consolidation of political regimes - a concept that has been overlooked in the transitional literature. Thus, this study set out to assess the importance of democracy and democratic consolidation on the economic development of 28 post-transition countries between 2000 and 2020.

The study employed a standard panel regression and evaluated four different model specifications to test the robustness of the results. Returning to the hypothesis posed at the beginning of the study, these findings support the notion that consolidation of political regimes has a vital role in economic development. The findings from the study suggest that an improvement by one point in the V-Dem index corresponds to an average rise in GDP per capita by 23.8%. The results remained robust after accounting for democracy stock and interaction between the level and duration of democracy. Each additional year a post-transition country spends in the democratic regime increases GDP per capita by 4.24% on average. In addition, the study found evidence of a U-shaped relationship between democratic consolidation and economic development. The estimated coefficient for the square value of democratic consolidation is negative, and this result confirms that the relationship between democratic consolidation and GDP per capita is convex. As it was emphasized, the convex relationship indicates that as a country becomes more democratically consolidated, the positive effects of democratic consolidation on economic development diminish. Regarding the effects of control variables included in the estimations, the results showed negative effects of inflation and government expenditure, while highlighting the positive impact of life expectancy, trade volume, and the initial GDP per capita level on economic development. The findings also revealed the statistically significant impact of EU membership and emphasized the negative effect of the agricultural sector's contribution on GDP per capita.

The study makes progress in the stagnant discussion on the democracy-development nexus, particularly in the context of transition countries. After the initial transition took place, little evidence was found in the empirical literature on the effects of democracy on economic development in these countries. Exactly three decades have passed following the initial transition, which permits to account for the period marked by the consolidation of political regimes and assess its effects on the current economic development of post-transition countries. Therefore, this analysis fills an important gap in the empirical literature on transition economies and underlines the timeliness and relevance of this paper. From an economic standpoint, these preliminary yet empirically grounded findings may lay an important foundation for policymakers and the international community that seek to sustain and promote democracy in order to drive economic progress. Also, these findings are of utmost importance for the countries that remained autocratic (e.g., Azerbaijan, Tajikistan, Belarus, and Russia), countries where the reverse democratization trend is currently evident (e.g., Serbia, Montenegro and Bulgaria), and especially EU countries (e.g., Hungary and Poland), where the polarization of democracy has been on the rise. For these nations, the results of this study offer critical insights that can inform policy decisions and actions aimed at mitigating challenges posed by shifting democratic landscapes. A further study with more focus on examining the dynamics of other social and economic factors that interact with democratic consolidation to shape favorable economic outcomes is needed. Therefore, subsequent research should intensify its focus by extending the analysis to investigate the impact of various channels through which democratic consolidation could impact economic development in post-transition countries. Some of the channels that could be investigated are education, social unrest, political stability, the level of technological advancement, and corruption levels. Investigation of these channels could assist researchers in understanding the intricate links between democracy and democratic consolidation, and ongoing economic development in these nations.

Reference List

- Alali, W. Y. (2022). *Role of Political Institutions on Economic Growth: Empirical Evidence*. University of Oxford. <https://ora.ox.ac.uk/objects/uuid:365d7742-bd59-4e46-999f-ac8b9c2abfc5>
- Acemoglu, D., Naidu, S., Restrepo, P., & Robinson, J. A. (2019). Democracy Does Cause Growth. *Journal of Political Economy*, *127*(1), 47–100. <https://doi.org/10.1086/700936>
- Acemoglu, D., & Robinson, J. (2001). *Why Nations Fail: The Origins of Power, Prosperity, and Poverty*. Crown Publishers
- Alizada, N., Boese, V. A., Lundstedt, M., Morrison, K., Natsika, N., Sato, Y., Tai, H., & Lindberg, S. I. (2022). *Democracy Report 2022: Autocratization Changing Nature?* V-Dem Institute. https://v-dem.net/media/publications/dr_2022.pdf
- Alizada, N., Cole, R., Gastaldi, L., Grahn, S., Hellmeier, S., Kolvani, P., Lachapelle, J., Lührmann, A., Maerz, S. F., Pillai, S., & Lindberg, S. I. (2021). *Democracy Report 2021: Autocratization Turns Viral*. V-Dem Institute. https://www.vdem.net/documents/12/dr_2021.pdf
- Asteriou, D., & Hall, S. G. (2011). *Applied Econometrics* (2nd ed.). Palgrave Macmillan.
- Balcerowic, L., & Gelb, A. (1994). Macropolicies in Transition to a Market Economy: A Three-Year Perspective. *The World Bank Economic Review*, *8*(1), 21–44. https://doi.org/10.1093/wber/8.suppl_1.21
- Barro, R. J. (1996). Democracy and growth. *Journal of Economic Growth*, *1*(1), 1–27. <https://doi.org/10.1007/BF00163340>
- Barro, R. J., & Lee, J. W. (2013). A new data set of educational attainment in the world, 1950–2010. *Journal of Development Economics*, *104*, 184–198. <https://doi.org/10.1016/j.jdeveco.2012.10.001>
- Batsaikhan, U., & Dabrowski, M. (2017). Central Asia - Twenty-five years after the breakup of the USSR. *Russian Journal of Economics*, *3*(3), 296–320. <https://doi.org/10.1016/J.RUJE.2017.09.005>
- Baum, M. A., & Lake, D. A. (2003). The Political Economy of Growth: Democracy and Human Capital. *American Journal of Political Science*, *47*(2), 333–347. <https://doi.org/10.2307/3186142>
- Bell, A., & Jones, K. (2015). Explaining Fixed Effects: Random Effects Modeling of Time-Series Cross-Sectional and Panel Data. *Political Science Research and Methods*, *3*(1), 133–153. <https://doi.org/10.1017/psrm.2014.7>

- Bieber, F. (2017). *Resilience in the Western Balkans. Too much resilience?* (Report No. 36). EU Institute for Security Studies. <https://op.europa.eu/en/publication-detail/-/publication/cf735c9f-a7e6-11e7-837e-01aa75ed71a1>
- Boese, V. A. (2019). How (not) to measure democracy. *International Area Studies Review*, 22(2), 95–127. <https://doi.org/10.1177/2233865918815571>
- Boese, V. A., & Eberhardt, M. (2021). *Democracy Doesn't Always Happen Over Night: Regime Change in Stages and Economic Growth* (Working Paper No. 114). V-Dem Institute. https://v-dem.net/media/publications/wp_114_final.pdf
- Bollen, K. A., & Paxton, P. (2000). Subjective Measures of Liberal Democracy. *Comparative Political Studies*, 33(1), 58–86. <https://doi.org/10.1177/0010414000033001003>
- Burkhart, R. E., & Lewis-Beck, M. S. (1994). Comparative Democracy: The Economic Development Thesis. *American Political Science Review*, 88(4), 903–910. <https://doi.org/10.2307/2082715>
- Busse, M. (2003). *Democracy and FDI* (Discussion Paper No. 220). Hamburg Institute of International Economics. <https://doi.org/10.2139/SSRN.384480>
- Campos N, Coricelli F, & Frigerio M. (2022). *The political U: New evidence on democracy and growth* (IZA Discussion Paper No. 15598). IZA Institute of Labor Economics. <https://dx.doi.org/10.2139/ssrn.4234912>
- Campos, N. F., & Coricelli, F. (2002). Growth in Transition: What We Know, What We Don't, and What We Should. *Journal of Economic Literature*, 40(3), 793–836. <https://doi.org/10.1257/002205102760273797>
- Campos, N. F., & Kinoshita, Y. (2003). *Why Does FDI Go Where it Goes? New Evidence from the Transition Economies* (IMF Working Paper No. 03/228). International Monetary Fund. <https://www.imf.org/en/Publications/WP/Issues/2016/12/30/Why-Does-Fdi-Go-Where-it-Goes-New-Evidence-From-the-Transition-Economies-16954>
- Christoffersen, P., & Doyle, P. (1988). *From Inflation to Growth: Eight Years of Transition* (IMF Working Paper No. 98/100). International Monetary Fund. <https://www.imf.org/external/pubs/ft/wp/wp98100.pdf>
- Cianetti, L., Dawson, J., & Hanley, S. (2018). Rethinking “democratic backsliding” in Central and Eastern Europe—looking beyond Hungary and Poland. *East European Politics*, 34(3), 243–256. <https://doi.org/10.1080/21599165.2018.1491401>
- Clague, C., Keefer, P., Knack, S., & Olson, M. (1996). Property and Contract Rights in Autocracies and Democracies. *Journal of Economic Growth*, 1(2), 243–276.

- Comeau, L. (2003). Democracy and Growth: A Relationship Revisited. *Eastern Economic Journal*, 29(1), 1–21.
- Coppedge, M., Gerring, J., Knutsen, C. H., Lindberg, S. I., Teorell, J., Alizada, N., Altman, D., Bernhard, M., Cornell, A., Fish, M. S., Gastaldi, L., Gjerløw, H., Glynn, A., Grahn, S., Hicken, A., Hindle, G., Ilchenko, N., Krusell, J., Marquardt, K. L., ... Ziblatt, D. (2022a). V-Dem [Country-Year/Country-Date] Dataset v12. In *Varieties of Democracy (V-Dem) Project*. <https://www.v-dem.net/data/the-v-dem-dataset/>
- Coppedge, M., Gerring, J., Knutsen, C. H., Lindberg, S. I., Teorell, J., Marquardt, K. L., Medzihorsky, J., Pemstein, D., Alizada, N., Gastaldi, L., Hindle, G., Pernes, J., von Römer, J., Tzelgov, E., Wang, Y., & Wilson, S. (2022b). *V-Dem Methodology v12*. Varieties of Democracy (V-Dem) Project. <https://v-dem.net/documents/2/methodologyv12.pdf>
- De Melo, M., Denizer, C., & Gelb, A. (1996). Patterns of Transition from Plan to Market. *The World Bank Economic Review*, 10(3), 397–424. <https://doi.org/10.1093/wber/10.3.397>
- De Melo, M., Denizer, C., Gelb, A., & Tenev, S. (2001). Circumstance and Choice: The Role of Initial Conditions and Policies in Transition Economies. *The World Bank Economic Review*, 15(1), 1–31. <https://doi.org/10.1093/wber/15.1.1>
- Deacon, R. T. (2009). *Dictatorship, Democracy, and the Provision of Public Goods*. UC Santa Barbara: Department of Economics. <https://escholarship.org/uc/item/9h54w76c>
- Doucouliafos, H., & Ulubaşoğlu, M. A. (2008). Democracy and Economic Growth: A Meta-Analysis. *American Journal of Political Science*, 52(1), 61–83. <https://doi.org/10.1111/j.1540-5907.2007.00299>
- Fidrmuc, J. (2003). Economic reform, democracy and growth during post-communist transition. *European Journal of Political Economy*, 19(3), 583–604. <https://doi.org/https://dx.doi.org/10.2139/ssrn.279819>
- Gerring, J., Bond, P., Barndt, W. T., & Moreno, C. (2005). Democracy and Economic Growth: A Historical Perspective. *World Politics*, 57(3), 323–364. <https://doi.org/10.1353/wp.2006.0002>
- Gerring, J., Thacker, S. C., & Alfaro, R. (2012). Democracy and Human Development. *The Journal of Politics*, 74(1), 1–17. <https://doi.org/10.1017/S0022381611001113>
- Giuliano, P., Mishra, P., & Spilimbergo, A. (2013). Democracy and Reforms: Evidence from a New Dataset. *American Economic Journal: Macroeconomics*, 5(4), 179–204. <https://doi.org/10.1257/mac.5.4.179>

- Glaeser, E. L., La Porta, R., Lopez-De-Silanes, F., & Shleifer, A. (2004). Do Institutions Cause Growth? *Journal of Economic Growth*, 9, 271–303.
<https://doi.org/10.2139/ssrn.556370>
- Gylfason, T. (2000). Resources, Agriculture, and Economic Growth in Economies in Transition. *Kyklos*, 53(4), 337–361. <https://doi.org/10.1111/1467-6435.00133>
- Hainz, C., Moffet, C., & Rhode, C. (2019). *Political and Economic Transition of Formerly Socialist Countries*. Ifo Institute.
<https://www.ifo.de/en/publications/2019/article-journal/political-and-economic-transition-formerly-socialist-countries>
- Hausman, J. A. (1978). Specification Tests in Econometrics. *Econometrica*, 46(6), 1251.
<https://doi.org/10.2307/1913827>
- Havrylyshyn, O., & Van Rooden, R. (1998). *Recovery and Growth in Transition Economies 1990-97: A Stylized Regression Analysis* (IMF Working Paper No. 98/141). International Monetary Fund.
<https://www.imf.org/external/pubs/ft/wp/wp98141.pdf>
- Helliwell, J. F. (1994). Empirical Linkages between Democracy and Economic Growth. *British Journal of Political Science*, 24(2), 225–248.
<https://doi.org/10.1017/S0007123400009790>
- Hernández-Catá, E. (1997). *Liberalization and the Behavior of Output during the Transition from Plan to Market* (IMF Staff Paper No. 97/53). International Monetary Fund. <https://www.imf.org/external/pubs/ft/wp/wp9753.pdf>
- Hollyer, J. R., Rosendorff, B. P., & Vreeland, J. R. (2011). Democracy and Transparency. *The Journal of Politics*, 73(4), 1191–1205.
<https://doi.org/10.1017/S0022381611000880>
- Huber, E., Rueschemeyer, D., & Stephens, J. D. (1993). The Impact of Economic Development on Democracy. *Journal of Economic Perspectives*, 7(3), 71–86.
<https://doi.org/10.1257/jep.7.3.71>
- Jensen, N. M. (2003). Democratic Governance and Multinational Corporations: Political Regimes and Inflows of Foreign Direct Investment. *International Organization*, 57(3), 587–616. <https://doi.org/10.1017/S0020818303573040>
- Kmezić, M. (2016). *EU Rule of Law Promotion* (1st ed.). Routledge.
<https://doi.org/10.4324/9781315580722>

- Kmezić, M. (2020). Rule of law and democracy in the Western Balkans: addressing the gap between policies and practice. *Journal of Southeast European and Black Sea*, 20(1), 183–198. <https://doi.org/10.1080/14683857.2019.1706257>
- Knutsen, C. H. (2021). A business case for democracy: regime type, growth, and growth volatility. *Democratization*, 28(8), 1506. <https://doi.org/10.1080/13510347.2021.1940965>
- Kohli, A. (1993). Democracy amid economic orthodoxy: Trends in developing countries. *Third World Quarterly*, 14(4), 685. <https://doi.org/10.1080/01436599308420350>
- Kurzman, C., Werum, R., & Burkhart, R. E. (2002). Democracy's effect on economic growth: A pooled time-series analysis, 1951–1980. *Studies in Comparative International Development*, 37(1), 3–33. <https://doi.org/10.1007/BF02686336>
- Lee, J.W., & Lee, H. (2016). Human capital in the long run. *Journal of Development Economics*, 122, 147–169. <https://doi.org/10.1016/j.jdeveco.2016.05.006>
- Leftwich, A. (1993). Governance, democracy and development in the Third World. *Third World Quarterly*, 14(3), 605–624. <https://doi.org/10.1080/01436599308420345>
- Li, Q., & Resnick, A. (2003). Reversal of Fortunes: Democratic Institutions and Foreign Direct Investment Inflows to Developing Countries. *International Organization*, 57(1), 175–211. <https://doi.org/10.1017/S0020818303571077>
- Linz, J. J. J., & Stepan, A. C. (1996). Toward Consolidated Democracies. *Journal of Democracy*, 7(2), 14–33. <https://doi.org/10.1353/jod.1996.0031>
- Lipset, S. M. (1959). Some Social Requisites of Democracy: Economic Development and Political Legitimacy. *American Political Science Review*, 53(1), 69–105. <https://doi.org/10.2307/1951731>
- Lutz, W., Stilianakis, N., Stonawski, M., Goujon, A., & Samir, K. (2018). Demographic and human capital scenarios for the 21st century : 2018 assessment for 201 countries. In *Publications Office of the European Union*. <http://dataexplorer.wittgensteincentre.org/wcde-v2/>
- Masaki, T., & Van de Walle, N. (2014). *The impact of democracy on economic growth in sub-Saharan Africa, 1982 - 2012* (Working Paper 2014/057). The United Nations University World Institute for Development Economics Research. <https://doi.org/10.35188/UNU-WIDER/2014/778-3>
- Matveeva, A. (1999). Democratization, legitimacy and political change in Central Asia. *International Affairs*, 75(1), 23–44. <https://doi.org/10.1111/1468-2346.00058>

- Mitchell, D. (2005). *The Impact of Government Spending on Economic Growth* (Report No. 1831). The Heritage Foundation. <https://www.heritage.org/budget-and-spending/report/the-impact-government-spending-economic-growth>
- Murtin, F., & Wacziarg, R. (2014). The democratic transition. *Journal of Economic Growth*, 19(2), 141–181. <https://doi.org/10.1007/s>
- Merkel, W. (2019). *Past, present and future of democracy – Policy review*. Publications Office of the European Union. <https://data.europa.eu/doi/10.2777/281418>
- North, D. C. (1990). *Institutions, Economic Theory, and Economic Performance*. Cambridge University Press. <https://doi.org/10.1017/CBO9780511808678.014>
- Olson, M. (1982). *The rise and decline of nations : economic growth, stagflation, and social rigidities*. Yale University Press.
- Pandya, S. S. (2014). Democratization and Foreign Direct Investment Liberalization, 1970–2000. *International Studies Quarterly*, 58(3), 475–488. <https://doi.org/10.1111/isqu.12125>
- Peev, E., & Mueller, D. C. (2012). Democracy, Economic Freedom and Growth in Transition Economies. *Kyklos*, 65(3), 371–407. <https://doi.org/10.1111/J.1467-6435.2012.00543>.
- Pei, M. (1999). *Economic, Institutions, Democracy and Development*. Carnegie Endowment for International Peace. <https://carnegieendowment.org/1999/02/26/economic-institutions-democracy-and-development-pub-66>
- Pelke, L. (2023). Reanalysing the link between democracy and economic development. *International Area Studies Review*, 26(4), 361–383. <https://doi.org/10.1177/22338659231194945>
- Persson, T., & Tabellini, G. (2007). *The Growth Effect of Democracy: Is It Heterogenous and How Can It Be Estimated?* (NBER Working Paper 13150). National Bureau of Economic Research. <https://doi.org/10.3386/w13150>
- Persson, T., & Tabellini, G. (2009). Democratic Capital: The Nexus of Political and Economic Change. *American Economic Journal: Macroeconomics*, 1(2), 88–126. <https://doi.org/10.1257/MAC.1.2.88>
- Pettersson, J. (2004). *Democracy, Consolidation and Growth*. http://www2.ne.su.se/paper/wp02_16.pdf

- Piatek, D., Szarzec, K., & Pilc, M. (2013). Economic freedom, democracy and economic growth: a causal investigation in transition countries. *Post-Communist Economies*, 25(3), 267–288. <https://doi.org/10.1080/14631377.2013.813137>
- Plümper, T., & Martin, C. W. (2003). Democracy, Government Spending, and Economic Growth: A Political-Economic Explanation of the Barro-Effect. *Public Choice*, 117(1), 27–50. <https://doi.org/10.1023/A:1026112530744>
- Pourgerami, A. (1991). The political economy of development: An empirical examination of the wealth theory of democracy. *Journal of Theoretical Politics*, 3(2), 189–211. <https://doi.org/10.1177/0951692891003002005>
- Przeworski, A., & Limongi, F. (1993). Political Regimes and Economic Growth. *Journal of Economic Perspectives*, 7, 51–69. <https://doi.org/10.1257/jep.7.3.51>
- Rachdi, H., & Saidi, H. (2015). Democracy and Economic Growth: Evidence in MENA Countries. *Procedia - Social and Behavioral Sciences*, 191, 616–621. <https://doi.org/10.1016/j.sbspro.2015.04.644>
- Rapacki, R., & Prochniak, M. (2019). EU Membership and Economic Growth: Empirical Evidence for the CEE countries. *The European Journal of Comparative Economics*, 16(1), 3–40.
- Repucci, S., & Slipowitz, A. (2022). *Freedom In the World 2022. The Global Expansion of Authoritarian Rule*. Freedom House. https://freedomhouse.org/sites/default/files/202202/FIW_2022_PDF_Booklet_Digital_Final_Web.pdf
- Roaf, James., Roaf, James., Joshi, Bikas., & Atoyian, Ruben. (2014). *Regional Economic Issues--Special Report 25 Years of Transition : Post-Communist Europe and the IMF*. International Monetary Fund. https://www.imf.org/external/region/bal/rr/2014/25_years_of_transition.pdf
- Rodrik, D., & Wacziarg, R. (2005). Do Democratic Transitions Produce Bad Economic Outcomes? *American Economic Review*, 95(2), 50–55. <https://doi.org/10.1257/000282805774670059>
- Scully, G. W. (1988). The Institutional Framework and Economic Development. *Journal of Political Economy*, 96(3), 652–662.
- Shleifer, A., & Treisman, D. (2014). Normal Countries: The East 25 Years After Communism. *Foreign Affairs*, 93(6), 92–103. <https://doi.org/10.1257/000282805774670059>

- Sirowy, L., & Inkeles, A. (1990). The Effects of Democracy on Economic Growth and Inequality: A review. *Studies In Comparative International Development*, 25(1), 126–157. <https://doi.org/10.1007/BF02716908>
- Stiglitz, J. E. (2002). Towards a New Paradigm for Development: Strategies, Policies and Processes. *Applied Econometrics and International Development*, 2(1), 116–122. <https://doi.org/10.7916/D8MC98VB>
- Tavares, J., & Wacziarg, R. (2001). How democracy affects growth. *European Economic Review*, 45, 1341–1378. [https://doi.org/10.1016/S0014-2921\(00\)00093-3](https://doi.org/10.1016/S0014-2921(00)00093-3)
- Treisman, D. (2020). Economic Development and Democracy: Predispositions and Triggers. *Annual Review of Political Science*, 23(1), 241–257. <https://doi.org/10.1146/annurev-polisci-050718-043546>
- United Nations (2001). *Economic survey of Europe. Economic growth and foreign direct investment in the transition economies*. United Nations. <https://digitallibrary.un.org/record/440663>
- Wolf, H. C. (1999). Transition Strategies: Choices and Outcomes. *Princeton Studies in International Finance*, 85, 1–22.
- World Bank, World Development Indicators (2022a). *Consumer price index (2010 = 100)* [FP.CPI.TOTL]. <https://databank.worldbank.org/source/world-development-indicators>
- World Bank, World Development Indicators (2022b). *Foreign direct investment, net inflows (% of GDP)* [X.KLT.DINV.WD.GD.ZS]. <https://databank.worldbank.org/source/world-development-indicators>
- World Bank, World Development Indicators (2022c). *GDP per capita (current US\$)* [NY.GDP.PCAP.CD]. <https://databank.worldbank.org/source/world-development-indicators>
- World Bank, World Development Indicators (2022d). *Mortality rate, infant (per 1,000 live births)* [SP.DYN.IMRT.IN]. <https://databank.worldbank.org/source/world-development-indicators>
- World Bank, World Development Indicators (2022e). *Trade (% of GDP)* [NE.TRD.GNFS.ZS]. <https://databank.worldbank.org/source/world-development-indicators>
- World Bank, World Development Indicators (2022f). *General government final consumption expenditure (% of GDP)* [NE.CON.GOV.T.ZS]. <https://databank.worldbank.org/source/world-development-indicators>

World Bank, World Development Indicators (2022g). *Agriculture, forestry, and fishing, value added (% of GDP)* [NV.AGR.TOTL.ZS].

<https://databank.worldbank.org/source/world-development-indicators>

World Bank, World Development Indicators (2022h). *Life expectancy at birth, total (years)* [SP.DYN.LE00.IN]. [https://databank.worldbank.org/source/world-](https://databank.worldbank.org/source/world-development-indicators)

[development-indicators](https://databank.worldbank.org/source/world-development-indicators)

Appendix

Table A1: Descriptive statistics

Variable	Obs	Mean	Std. dev.	Min	Max
lnGDPpc	560	8.592	0.863	6.064	10.091
Democracy	560	0.486	0.237	0.0486	0.807
DemocracyDuration	560	4.316	6.286	0	21
DemocracyConsolidation	560	2.913	4.310	0	16.119
DemocracyConsolidation2	560	27.037	51.855	0	259.841
InitialGDPpc	560	8.118	0.889	6.064	9.695
Inflation	521	7.143	11.924	-5.153	168.62
GovernmentExpenditure	545	16.816	3.983	5.941	29.940
FDI	537	5.766	8.369	-40.081	109.330
Trade	534	100.265	32.354	22.492	190.698
LifeExpectancy	560	72.862	3.615	61.974	81.529
EU	560	0.386	0.487	0	1
AgricultureShare	548	8.848	7.161	1.541	34.541

Table A2: Estimation results - FE vs. RE

Independent variable	Model 1		Model 2		Model 3		Model 4	
	FE	RE	FE	RE	FE	RE	FE	RE
Dependent variable								
Democracy	0.355** (0.102)	0.129*** (0.0991)	0.281** (0.104)	0.240** (0.102)	0.248** (0.118)	0.170*** (0.116)	0.238** (0.103)	0.164*** (0.116)
DemocracyDuration			0.0380*** (0.00746)	0.0302*** (0.00794)	0.0360*** (0.00820)	0.0251*** (0.00876)	0.0321*** (0.00703)	0.0249*** (0.00722)
DemocracyConsolidation			0.0588*** (0.0116)	0.0435*** (0.0125)	0.0549*** (0.0177)	0.0238*** (0.0189)	0.0424*** (0.0153)	0.01637*** (0.0158)
DemocracyConsolidation2					-0.000350*** (0.000568)	-0.000869** (0.000614)	-0.000999** (0.000479)	-0.000809** (0.000479)
lnInitialGDPpc	0.168** (0.0257)	0.199*** (0.0405)	0.147** (0.0433)	0.181*** (0.0419)	0.114*** (0.0781)	0.180*** (0.0423)	0.101*** (0.0777)	0.124*** (0.0458)
Inflation	-0.00203*** (0.000693)	-0.00208*** (0.000751)	-0.00169** (0.000677)	-0.00194*** (0.000735)	-0.00185*** (0.000677)	-0.00191*** (0.000734)	-0.00122** (0.000571)	-0.00130** (0.000568)
GovernmentExpenditure	-0.0214*** (0.00363)	-0.0260*** (0.00373)	-0.0229*** (0.00351)	-0.0260*** (0.00369)	-0.0201*** (0.00361)	-0.0252*** (0.00371)	-0.0268*** (0.00298)	-0.0246*** (0.00306)
Lifexpectancy	0.111*** (0.00377)	0.0997*** (0.00393)	0.115*** (0.00434)	0.100*** (0.00447)	0.116*** (0.00439)	0.101*** (0.00447)	0.0732*** (0.00407)	0.0812*** (0.00445)
FDI	0.000445 (0.000800)	2.36e-05 (0.000868)	0.000776 (0.000781)	0.000236 (0.000855)	0.000471 (0.000785)	0.000257 (0.000852)	4.66e-05 (0.000660)	0.000141 (0.000654)
Trade	0.000703*** (0.000364)	0.000517 (0.000376)	0.0002113*** (0.000391)	0.000400 (0.000428)	0.00108*** (0.000418)	0.000400 (0.000427)	0.000959*** (0.000357)	0.000595 (0.000376)
EU							0.0205** (0.0572)	0.0161** (0.0664)
AgricultureShare							-0.0317*** (0.00222)	-0.0287*** (0.00239)
Constant	0.644** (0.289)	-3.999*** (0.375)	0.365** (0.333)	-3.948*** (0.422)	0.138** (0.347)	-3.993*** (0.424)	-0.844* (0.466)	3.505*** (0.381)
Observations	560	560	560	560	560	560	560	560
R-squared	0.702	0.693	0.716	0.707	0.718	0.708	0.794	0.795
Number of CountryID	28	28	28	28	28	28	28	28

Notes:

- (1) *, **, *** - Statistically significant impact at 1%, 5% and 10 % significance level, respectively;
(2) Robust standard errors in parenthesis.

Table A3: Hausman test statistics

Model 1	Model 2	Model 3	Model 4
Test of H0: Difference in coefficients not systematic	Test of H0: Difference in coefficients not systematic	Test of H0: Difference in coefficients not systematic	Test of H0: Difference in coefficients not systematic
$\chi^2(6) = (b-B)'[(V_b - V_B)^{-1}](b-B)$	$\chi^2(7) = (b-B)'[(V_b - V_B)^{-1}](b-B)$	$\chi^2(9) = (b-B)'[(V_b - V_B)^{-1}](b-B)$	$\chi^2(11) = (b-B)'[(V_b - V_B)^{-1}](b-B)$
= 74.28	= 133.59	= 108.28	= 101.95
Prob > χ^2 = 0.0000	Prob > χ^2 = 0.0000	Prob > χ^2 = 0.0000	Prob > χ^2 = 0.0000