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Political Institutions and Economic Growth

The relation between institutions and economic growth is one of the most debated issues in recent economic growth literature. It is clear, that there is a high correlation between the quality of a society's institutions and its economic development. The most important questions discussed in this debate are (i) the causal relation between institutions and growth: Do good institutions cause growth and/or does growth allow for good institutions? and (ii): What is the relation between institutions and geography? For methodological reasons it is rather difficult to give clear answers to these two questions.

If we let aside these methodological problems and accept that institutions play a major role for economic development the question is which kind of institutions do we need to favour this development. The most important ones are those institutions that support economic freedom and the rule of law: They allow for stable expectations as well as building up human and physical capital.

With respect to political institutions, the main question is whether democracy is favourable to economic growth. Of course, today those (larger) countries with the highest per capita income in the world are democracies. But it might only be the case that rich countries just can afford to be democratic while poorer countries have to pay for more democracy with lower growth. Most contributions to this discussion tend to see a positive role for democracy in the economic process, but the prima facie evidence is at least mixed.

Considering Switzerland, the most heatedly debated question is whether its direct democracy as well as its federal system are responsible for the rather low growth rates of the last two decades.



It is obvious that these rather special Swiss institutions have evolved over time and not been developed with special consideration of promoting economic growth. One might think of other institutions which might be better in this respect. Nevertheless, empirical evidence indicates that direct democracy and federalism do at least not impede economic growth. This also holds for Switzerland.