

Democracy, Education and the Quality of Government[‡]

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April 2012

Abstract

This paper looks at how the interaction between democracy and education affects the quality of government. Using cross-country and panel data regressions we show that the success of democratic institutions is closely related to the quality of the electorate measured by the level of education in the population. Democratic elections do not foster (and may possibly dampen) the quality of government in countries with largely uneducated populations. We also propose a simple model of politicians recruitment which illustrates one of the possible channel of interaction between political institutions and education.

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[†]We are grateful for useful comments and suggestions on an earlier version of this paper to Alberto Chong, Aart Kraay, Florencio López de Silanes, Torsten Persson, and Giacomo Ponzetto.

“You know the way in which dyers first prepare the white ground and then lay on the dye of purple or of any other colour. Colours dyed in this way become fixed, and no soap or lye will ever wash them out. Now the ground is education, and the laws are the colours; and if the ground is properly laid, neither the soap of pleasure nor the lye of pain or fear will ever wash them out.” (Plato, *The Republic*, Book IV)

1 Introduction

One of the most widely cited definition of democracy is Abraham Lincoln’s “government of the people, by the people, and for the people,” formulated in his Gettysburg address in 1863. Periodic, free, fair, broadly participatory, and genuinely contested elections would give to the people the power to control directly the government and therefore to ensure the implementation of policies favoring the population as a whole rather than specific (political or economic) elites. The standard efficiency argument advanced in political science and economics in favor of democratic institutions relies broadly on this vision, and suggests that democracy gives the right incentives to elected officials because free elections provide to the voters an instrument to oust inept and corrupt individuals from power (Sen, 2000, and Rivera-Batiz, 2002). In this sense democratic institutions would be both responsive to the demands of its constituents and effective in using limited resources to address these demands. Available empirical evidence however suggests (if anything) only a weak correlation between the extension of democratic liberties and good policy making. Countries with similar degree of democratic liberties exhibit large heterogeneity in the quality of governance. This is illustrated in Figure 1 which plots the relationship between a measure of democracy obtained using an average of the Polity and Freedom House indexes and a standard indicator of government quality in the year 2008.

How can we make sense of these discordant experiences? Why only some democratic governments deliver good policies and others do not? Or, to put it as Robert D. Putnman did in his famous book on democracy in Italy, how can we make democracy work?

This paper looks at the role played by education for the functioning of modern democracies and proposes the idea that the success or failure of democratic institutions is ultimately linked to the spread of education throughout the population. Almond and Verba (1963) suggest that “the uneducated man or the man with limited education is a different political actor from the man who has achieved a higher level of education,” and we should therefore expect different political outcomes depending on the level of education of the electorate. Education, in fact, enhances political engagement and participation but it also enable citizens to make more pondered (*ex ante*) electoral choices and to evaluate more carefully (*ex post*) the actions of elected officials.

We bring this idea to the data and show that the interaction between democracy and education is positively correlated with the quality of government using both cross-sectional and longitudinal data. Next, we check the behavior of the

marginal effect of democracy and we find that the correlation between democracy and the quality of government is not statistically significant in countries with low levels of education and is positive and statistically significant in countries with high levels of education. We also find a positive and (often) statistically significant marginal effect of education on governance only in democratic countries. This ancillary result is in line with the Hirschman's (1970) idea that voice is necessary to channel the views and ideas of an even educated electorate into government performances.

In discussing our results, we acknowledge that we cannot make any claim of causality because our explanatory variables are likely to be endogenous and we do not have good instruments for education and democracy. We deal with this issue by running a set of Monte Carlo simulations aimed at testing the robustness of our results. We find that our results are fairly robust. Even the presence of extreme endogeneity would not reverse our results. In the worst case scenario, the point estimates of our parameters of interest would be statistically insignificant.

Our results reconcile the discordant literature on the relative merits of democracy and education in promoting good governance and economic development. While Acemoglu et al. (2001) and Persson and Tabellini (2006, 2008 and 2009) emphasize the primacy of political institutions as a fundamental factor to explain cross-country differences in income per capita,¹ other authors find no evidence of a significant effect of democracy on development (Barro, 2000, and Przeworski et al., 2000).² Djakanov et al. (2003) suggest that each community faces a set of institutional opportunities determined by the human and social capital of its population which, in turn, affect the quality of government. Glaeser et al. (2004) produce empirical evidence in line with this view, and argue that, as postulated by Lipset (1959, 1960), human capital accumulation and growth cause institutional improvements.^{3,4} By looking carefully at the interaction between democracy and education we find that these two variables rather complement each other and put into perspective the predictions of Glaeser et al. (2006) who suggest that stable democratic institutions cannot flourish in the absence of a

¹In a recent book, Besley and Persson (2011) stress the importance of cohesive political institutions that promote common interests and guarantee the provision of public goods as a crucial determinant of economic development.

²Empirical papers that find that transitions to democracy are positively correlated with economic growth include Rodrik and Wacziarg (2005) and Papaioannou and Siourounis (2008). Cervellati et al. (2011), instead, distinguish peaceful from violent democratizations and find that the level of violence during the transition have persistent effects on the quality of emerging democracies. In related contributions Cervellati et al. (2008) and Sunde et al. (2008) predict and document that in unequal societies democracy is negatively correlated with the rule of law. In the political science literature, the effects of democratization on development are still debated (Carbone, 2009).

³Acemoglu et al. (2005) argue that the results of Glaeser et al. (2004) are not robust to using fixed effects. However, Bobba and Coviello (2007) and Castello-Climent (2008) find a positive relationship between education and democracy, even when they control for country fixed effects.

⁴Chong and Gradstein (2009) use micro data from the World Values Surveys and find a positive association between education and pro-democracy attitudes even after controlling for a variety of personal characteristics.

sufficiently educated population because schooling raises the benefits of civic participation, including voting and organizing.

In what follows, we first review the competing explanations of why we should expect an heterogeneous effect - by educational level - of democracy on the quality of government (Section 2). We then present our empirical investigation and look at the association between a standard indicator of the quality of government and the interaction between democracy and education (Section 3). Section 4 addresses endogeneity. Finally, Section 5 proposes a simple model of politicians recruitment which delivers predictions in line with our empirical results and Section 6 concludes.

2 Democratic Governance and Education

In the last decades the diffusion of democracy beyond its historical boundaries in the Western hemisphere put the understanding of the performance of democratic institutions, and its dependence on the cultural surround, at the center of the research agenda of political scientists and economists alike.

Modern political science looks to the sociocultural determinants of democratic governance since the seminal study of Almond and Verba (1963) on *civic culture*, which seeks to explain cross-national variations in the performances of democratically elected governments through an examination of the differences in political engagement and orientations of their respective populations. In a contemporary classic of the genre, Putnam (1993) builds up on this work and proposes the idea that democracy requires social capital to operate fruitfully. An active and public-spirited citizenry populated by trustful (and trustworthy) individuals willing to cooperate among each other would be essential for the flourishing of democratic institutions. He showed that the newly empowered regional governments introduced in Italy in the early 1970s with fairly similar organizational structures succeeded only in those regions blessed with vibrant networks and norms of civic engagement. Where social life was fragmented and culture of distrust diffuse, instead, the performances of the new executive bodies were less responsive to public demands and politics took on patron-client characteristics.⁵ This latter scenario resembles Banfield's idea of *amoral familism*, defined as a social equilibrium in which people care exclusively about their nuclear family (and expect everybody else behaving likewise), disregard common goods and therefore prevent the development of well functioning political institutions (Banfield, 1958). More recent contributions confirm Putnam's results by replicating the analysis with up-to-date and more disaggregated data (John et al., 2010, and Rice and Sumer, 1997).

Economic literature has been generally examining democratic governance from a different perspective, that of informational asymmetries between citizens and policymakers. The classic political economy models centred exclu-

⁵In a related contribution, Sunde et al. (2008) find evidence for a significant interaction effect between democracy and equality in determining the quality of governance. Democracy is associated with better rule of law when inequality is low.

sively around the problem of moral hazard in politics (Barro, 1973, and Ferejohn, 1986). In a world in which the actions of a policymaker are only partly observable by the citizens, elected officials face strong incentives to appropriate rents. As information goes up, however, political accountability rises, and the space left for the rent-seeking declines (Adsera et al., 2003).⁶ More recent work has emphasized the importance of politician characteristics, in terms of talent, virtue or preferences, in explaining the quality of governance.⁷ This strand of literature puts greater emphasis on the way public officials are recruited and on problems of adverse selection. These models suggest that bad politicians are relatively more likely to enter when formal returns to politics are low and more likely to be selected if information about politicians quality is limited making it difficult to spot the best candidates (Caselli and Morelli, 2002 and Besley et al., 2005).

These different explanations for the successes and failures of democratic government are not mutually exclusive. They are, rather, accumulated by the same underlying factor: the educational attainment of the population. Education strengthens trust and civic norms by reducing uncertainty about the behavior of others, trains people to behave cooperatively and raises the benefits of social and political participation (Ostrom, 2006 and Knack and Keefer, 1997). And in fact in most empirical analysis education appears as the strongest predictor of political engagement (e.g., Shields and Goidel 1997; Verba et al., 1996; Wolfinger and Rosenstone 1980). On the other hand, education equips citizens with the cognitive skills they need to be effective participants in a representative democracy, increases their ability to select able leaders, understand the issues upon which they vote, and recognize corrupted public officials (Milligan et al., 2004).

In synthesis, education can be described as “the best proxy for both information and civic virtues” (Alesina and Giuliano, 2011, p.8) and may affect the functioning of democratic institutions by fostering social capital and at the same time reducing informational asymmetries. We should therefore expect an effect of democracy on the quality of government which is heterogeneous by educational level.

In the next section we take this hypothesis to the data and look at the how democracy, education and the interaction between them correlate with the quality of governance.

⁶From an empirical perspective, an important strand of literature studies the role of the media as a source of discovery and dissemination of information and suggests that increased media presence improves electoral accountability (e.g., Besley and Burgess, 2002, Djankov et al. 2003, and Besley and Prat, 2006). In a more recent contribution Djankov et al. (2010) focus on an alternative source of information, the disclosure of politicians’ finances and business activities. They collect data on the rules and practices of disclosure by politicians and find a negative association between public access to disclosed information and perceived corruption.

⁷The quality dimension in political selection has been studied in a citizen-candidate framework by Besley and Coate (1997) and Poutvarra and Takalo (2007).

3 Data and Empirical Analysis

It should be clear from the outset that we have no convincing way to identify a causal relationship going from democracy and education to the quality of government. Therefore, the objective of this section is to check whether the partial correlations between the quality of government and each of education and democracy are consistent with our hypothesis, without making any claim on the causality of these partial correlations. In the next section we investigate the endogeneity problem. We show that our results are robust to allowing for a mild form of endogeneity.

3.1 The Data

We measure the quality of government with an aggregate index obtained from the International Country Risk Guide (ICRG) built up by jointly considering corruption and competency indicators. In particular, our quality of government index (*QOG*) is the simple average of the ICRG variables “Corruption,” “Law and Order,” and “Bureaucracy Quality.” Note that corruption and bureaucracy quality are highly correlated in the data.^{8 9}

The aggregate index of quality of government ranges between 0 and 100, with higher values being associated with higher quality of government. The average value of the index was approximately 52 in the 1980s, 58 in the 1990s and 55 in the 2000s (Table A1). The quality of government index is fairly stable and most of the variance of the index comes from its cross-country variation (the “between,” standard deviation of the index is about 20 and the “within,” standard deviation is approximately 7, Tables A2-A4).

We measure democracy (*DEMOC*) using an average of the Polity and Freedom House indexes of democracy. Our measure of democracy ranges between 0 and 10 (again, with higher values associated with greater levels of democracy). While the average value of the index increased from 4.8 in the 1980s to 7.1 in the 2000s, the dispersion of the index decreased markedly with the cross-country standard deviation going from 3.5 in the 1980s to 2.8 in the 2000s (Table A1). Again, the cross-country variance of the index is much larger than the within-country variance.

For our third variable of interest we rely on the Barro and Lee (2010) dataset on educational attainment. We measure education (*EDUC*) with the average number of years of education attained by the adult population. In the data, this variable ranges between 2.8 and 13. Its average value increased from 5.2 in the 1980s to 7.5 in the 2000s. Its standard deviation, instead, remained constant at approximately 2.8. As for the previous two variables, the cross-

⁸The correlation between the ICRG index of bureaucratic quality and that of control of corruption is 0.63 (the coefficient is statistically significant at the one percent confidence level). A regression of the index of control of corruption over that of bureaucratic quality yields a coefficient of 0.8 and a t-statistics of 11.8.

⁹In line with this evidence, one of the predictions of the simple model presented at the end of the paper is that less competent politicians endogenously adopt more predatory behaviours.

country standard deviation of education is much larger than the within-country standard deviation (2.9 versus 0.8, Table A3).

In estimating the relationship between quality of government and our explanatory variables, we follow La Porta et al. (1999) and control for the log of GDP per capita, legal origin, religion, ethno-linguistic fractionalization, and latitude. Following Ades and Di Tella (1999), we also control for trade openness.¹⁰

3.2 Cross-country estimates

We start by looking at the cross-country relationship between the quality of government (QOG) and each of democracy and education, and run separate regressions for the 1980s, 1990s, and 2000s. Columns 1, 3 and 5 of Table 1 show that education ($EDUC$) is never significantly correlated with QOG and that democracy ($DEMOC$) is positively but not always significantly correlated with QOG .

These preliminary estimates, however, assume that the effects of democracy and education on the quality of government are independent of each other. Our working hypothesis, instead, suggests a positive interaction between these variables. It suggests that we should find a positive correlation between democracy and quality of government only in countries with high average levels of education. In countries with low levels of education democracy should not matter and may even be associated with low quality of government.

We test for the presence of an interaction between education and democracy by estimating the following model:

$$QOG_i = \alpha + \beta(DEMOC_i - \overline{DEMOC}) + \gamma(EDUC_i - \overline{EDUC}) + \delta(DEMOC_i - \overline{DEMOC})(EDUC_i - \overline{EDUC}) + X_i\lambda + \varepsilon_i$$

Within this set up, $\frac{\partial QOG}{\partial DEMOC} = \beta + \delta(EDUC_i - \overline{EDUC})$, with β measuring the relationship between democracy and the quality of government for the country with average level of education and δ measuring how the level of education affects the relationship between democracy and the quality of government. Similarly, $\frac{\partial QOG}{\partial EDUC} = \gamma + \delta(DEMOC_i - \overline{DEMOC})$, with γ measuring the relationship between education and the quality of government for the country with average level of democracy and δ measuring how the level of democracy affects the relationship between education and the quality of government.

Columns 2, 4, and 6 of Table 1 show that β is always positive and statistically significant, indicating that there is a positive relationship between democracy and the quality of government for the country with the average level of education (in the year 2000 the group of countries with a level of education around the cross-country average of 7.5 included Ecuador, South Africa, Mexico, Jordan, and Sri Lanka). They also show that γ is never statistically significant,

¹⁰Our control variables and their sources are described in Table A5.

indicating that there is no robust relationship between education and the quality of government for the country with the average level of democracy (in the year 2000, the group of countries with a level of democracy around the cross-country average of 7.1 included Thailand, Mozambique, Colombia, Ukraine, and Turkey). Finally, Table 1 shows that δ is always positive and statistically significant, supporting the idea of a positive interaction between democracy and education for the quality of government.

Figure 2 plots the partial correlation between $DEM * EDUC$ and QOG for each of the three sub-periods studied in Table 1 and for all the sub-periods pooled together. It suggests that the the point estimates of Table 1 are not driven by outliers.

The bottom panel of Table 1 evaluates the relationship between democracy and the quality of government for countries with a level of education which is one standard deviation below the cross-country average (examples of such countries are Uganda, Pakistan, Laos, and Haiti) and for countries with a level of education which is one standard deviation above the cross-country average (Russia, Latvia, Romania, and Switzerland). We find no significant relationship between democracy and the quality of government for countries with low levels of education and a strong and significant correlation between democracy and the quality of government for countries with high levels of education.

We also look at the relationship between the quality of the government and education for different levels of democracy (countries which in the year 2000 had a level of democracy one standard deviation below the cross-country average include Morocco, Kuwait, Chad, and Mauritania and countries that in the year 2000 had a level of democracy one standard deviation above the cross-country average include Greece, Japan, Chile, and Italy). In all cases, we find a negative correlation for low levels of democracy and a positive correlation for high levels of democracy. If we focus on the 1980s, we find that the negative correlation for low levels of democracy is statistically significant at the 5 percent confidence level but the positive correlation for high levels of democracy is not statistically significant. For the 1990s and 2000s, instead, we find that the correlation between education and quality of government is positive and statistically significant in countries with high levels of democracy and negative and insignificant for countries with low levels of democracy.

Figure 3 uses the results of the 2000s regression to plot the relationship between the quality of government and democracy at different levels of education. It shows that the relationship is negative and statistically significant for countries with extremely low levels of education (below one year of average schooling) and is positive and statistically significant for all countries in which average education is above 7 years.¹¹ The results are thus fully consistent with our hypothesis.

Figure 4 uses the results of the 2000s regression to plot the marginal effect of education at different levels of democracy. It shows that the relationship is

¹¹In the 2000s there was only one country with average education below one year (Mozambique) and there were 73 countries with average education above 7 years.

negative and statistically significant for countries where the democracy index is below 2.5 and positive and statistically significant for countries where the democracy index is above 9.¹²

In the first two columns of Table 2 we check whether our results are robust to using an alternative measure of education. In particular, we substitute the Barro and Lee (2010) measure of average years of education with the Vanhanen (2003a, 2003b) index of knowledge distribution (*EDUC1*) computed as the simple average of literates as a percentage of adult population and the number of students at universities or other higher education institutions per 100,000 inhabitants of the country. The index is rescaled to range between 0 and 100 (in the 1980s the average value of the index was 43, in the 1990s the average value had increased to 51; the cross-country standard deviation of the index is approximately 21 and the within-country standard deviation is about 4). While this index is not available for the 2000s and is less commonly used than the Barro and Lee measure of the stock of education, it has the advantage of being available at annual frequency (the Barro and Lee measure of education is only available at a 5-year frequency). Therefore, it can be used to estimate panel regressions that use annual data.¹³ We find that substituting *EDUC* with *EDUC1* does not affect our results (this is not surprising since the correlation between the two variables is 0.87).

In the last three columns of Table 2, we re-estimate the models of columns 2, 4, and 6 of Table 1 by using a robust regression method which puts less weight on outliers (in particular, we use the `reg` command of Stata) and find results which are basically identical to those of Table 1. This confirms that our findings are not driven by outliers.

3.3 Panel regressions

In Table 3, we use ten year averages to estimate random and fixed effects models by pooling the data for the three decades of the regressions of Table 1. We start with a random effects model without the interaction between democracy and education (column 1) and again we find a positive and significant effect of democracy and a positive but insignificant effect of education. We find similar results when we control for the interaction between democracy and education and estimate the effect of democracy and education at their respective mean

¹²In the 2000s there were 28 countries that in the 2000s had a democracy index below 2.5 (Saudi Arabia; North Korea; Iraq; Turkmenistan; Uzbekistan; Myanmar; Libya; Afghanistan; Cuba; Syria; Qatar; Laos; China; Sudan; Swaziland; Eritrea; Belarus; Vietnam; United Arab Emirates; Equatorial Guinea; Oman; Bhutan; Azerbaijan; Bahrain; Zimbabwe; Cameroon; Kazakhstan; Egypt) and 39 countries that in the 2000s had a democracy index above 9 (Bulgaria; Latvia; South Africa; Panama; Israel; Taiwan; Greece; Estonia; Japan; Chile; Czech Republic; Slovakia; France; Mauritius; Lithuania; Poland; Belgium; Costa Rica; Hungary; Italy; United Kingdom; Slovenia; Germany; Spain; Ireland; New Zealand; Cyprus; Portugal; Uruguay; Austria; Australia; Finland; Sweden; Norway; Netherlands; United States; Switzerland; Denmark; Canada).

¹³Moreover, by focusing on both the top (tertiary enrollment) and bottom (basic literacy) parts of the distribution of education outcome, this index may do a better job at capturing inequalities in the distribution of education.

value (column 2). As in Table 1, we find that the interactive term is positive and statistically significant, indicating that democracy and education are complementary. In column 3, we estimate the model without interaction but with country fixed effects (this specification does not allow to include time-invariant controls) and find that neither education nor democracy are statistically significant. However, when we allow for an interactive effect we find that democracy is statistically significant (indicating that for the country with the average level of education democracy is positively correlated with the quality of government) and so is the interactive term capturing complementarities between democracy and education. This is a remarkable result if one considers that in the fixed effects model the limited within-country variance of democracy and education amplifies the downward bias brought about by the presence of measurement error.

Figure 5 uses the results of the fixed effects regression to plot the relationship between the quality of government and democracy at different levels of education.¹⁴ It shows that, in line with our hypothesis, the relationship is negative (but not statistically significant) for countries with low levels of education (less than 4 years) and becomes positive and statistically significant when average education reaches 8 years. When we plot the relationship between the quality of government and education at different levels of democracy (Figure 6) we find that the relationship is insignificant for low and intermediate levels of democracy but it becomes positive and significant when the democracy index surpasses 9.

In Table 4 we estimate panel regressions using 5 year averages instead of 10 year averages and find that the results are qualitatively similar to those of Table 3. As before, we find that the relationship between democracy and the quality of government is positive and statistically significant only for high levels of education while it is negative (but not statistically significant) when the average level of education is below 3 (Figure 7). As for the relationship between education and the quality of government, it is positive and statistically significant for high level of democracy but now it becomes negative and significant for extremely low values of democracy (Figure 8).¹⁵

In Table 5 we repeat the experiment using annual data and the Vanhanen (2003a, 2003b) index of knowledge distribution (*EDUC1*). We find that both education and democracy are positively correlated with *QOG* when they are evaluated at their mean value and, as before, we find a positive and statistically significant coefficient for the interactive term. Figure 9 shows that when we look at the relationship between democracy and quality of government we find the usual result of a negative but insignificant relationship for countries with low level of education and a positive and significant relationship for countries with intermediate and high levels of education. The relationship between education and the quality of government is always positive and becomes statistically significant for countries with intermediate and high levels of democracy (Figure

¹⁴We use the fixed effects regression because a Hausman test rejects the null that the random effects model is consistent ($\chi(6) = 10.75, p = 0.09$).

¹⁵The graph is based on the results of the fixed effects regressions because a Hausman test show that the random effects regression is not consistent ($\chi^2(5) = 13.08, p = 0.02$).

10).

While many of our explanatory variables are likely to be endogenous, one variable we are particularly worried about is the log of GDP per capita, as there is strong evidence that institutional quality has a causal effect on the level of development (Acemoglu et al., 2001). While we do not have a good instrument for the level of GDP, we do have a good instrument for GDP growth. Recognizing that, with fixed effects and annual data, the level of GDP and GDP growth are closely related concepts, in Table 6 we replace the log of GDP per capita with GDP growth (*GROWTH*) and then instrument GDP growth with the real external shock first used by Jaimovich and Panizza (2006). We find that the results of the IV regressions are essentially identical to those of the standard regressions which, in turn, are similar to those in which we control for the log of GDP instead of GDP growth.

Finally, we recognize that the quality of government is likely to be persistent and we estimate the relationship between *QOG* and each of education and democracy by using a dynamic panel estimator. Column 1 of Table 7 reports the results of the GMM difference estimator originally proposed by Arellano and Bond (1991).¹⁶ The results of the dynamic panel estimations show strong persistence (with the first and second lag being highly significant) and confirm our previous result of a positive and significant effect of democracy, education, and of the interaction between these two variables. The model also passes the standard specification tests: the residuals exhibit first order autocorrelation but no second order autocorrelation and the Sargan test does not reject the null on the appropriateness of our exclusion restrictions. We also used the system GMM estimator proposed by Arellano and Bover (1995) and Blundell and Bond (1998) because, under certain conditions, this model allows to make casual statements, but the Sargan test always rejected our exclusion restrictions (Columns 2 and 3 of table 7).

4 Non-Robustness Analysis

The main issue with the estimations of Section 3 relates to the endogeneity of our variables of interest and of some of our controls. The quality of government is likely to have a direct effect on education and GDP per capita and also have an either direct or indirect effect on democracy and trade openness. Although, we tried to deal with the endogeneity problem by using panel data and different GMM estimators, we are not convinced to have fully dealt with the problem.

In the absence of proper instruments there is no solution to the endogeneity problem. Therefore, in this Section we follow Bourguignon et al. (2007) and explore the magnitude of the potential bias in the estimation of our parameters of interest. In a sense, we check how "non-robust" our results are under different assumptions on the severity of the endogeneity problem.

¹⁶We use all available lags as instrument and adjust the standard errors using Windmeijer (2005) finite sample correction. We consider a model with two lags because in the model with one lag we could not reject the null of no second order autocorrelation of the residuals.

Our objective is to estimate the following model:

$$Q_i = \alpha + X_i\beta + W_i\lambda + u_i$$

Where Q is the quality of government, X is a matrix of endogenous variables (democracy, education, the interaction between democracy and education, GDP per capita, and openness) and W is a matrix of exogenous variables (Ethno-linguistic fractionalization, legal origin, religion, and latitude). Because of endogeneity, X and u are not orthogonal and the vector $\widehat{\beta}$ will be a biased estimator of β (possibly also causing a bias in $\widehat{\lambda}$).

If we had a set of valid instruments (i.e., a set of variables correlated with X but uncorrelated with u), we could use an IV estimator and obtain an unbiased estimator of the vector β . In the absence of such a set of instruments, we can compute how the correlation between u and X affects the bias of $\widehat{\beta}$ and then correct for this bias.

To see how this can be done let us start by assuming, without loss of generality, that all variables are endogenous and have mean zero.¹⁷ The expected value of the OLS estimator will then be:

$$E(\widehat{\beta}) = (X'X)^{-1} X'Q = \beta + (X'X)^{-1} E(X'u) \quad (1)$$

As $E(X'u) = \text{cov}(Xu)N$ (where N is the number of observations), we can write the bias of the OLS estimator as $B = E(\widehat{\beta}) - \beta = (X'X)^{-1} \text{cov}(Xu)N$. By recalling that $\rho_{Xu} = \text{cov}(Xu)/(\sigma_x\sigma_u)$, we have,

$$B = N(X'X)^{-1} \left(\rho_{Xu}\sigma_x \right) \sigma_u \quad (2)$$

Where σ_u is the standard deviation of u and $\rho_{Xu}\sigma_x$ is a $k \times 1$ vector in which each element is the product between the standard deviation of the k^{th} variable in X and the correlation between u and the k^{th} variable in X .¹⁸ In order to evaluate the bias we need a guess about σ_u (which can only be estimated if we have an unbiased estimate of β) and ρ_{Xu} . We can instead estimate σ_x .

Bourguignon et al. (2007) start by observing that:

$$\sigma_u^2 = \frac{E(u'u)}{N} + \frac{E}{N} \left[(\widehat{\beta} - \beta)' (X'X) (\widehat{\beta} - \beta) \right]$$

and suggest that if the expected bias is estimated with enough precision σ_u^2 can be proxied by:

$$\sigma_u^2 \cong \widehat{\sigma}_u^2 + \frac{B'X'XB}{N} \quad (3)$$

By plugging (2) into (3), we can obtain the following estimator for σ_u^2 :

¹⁷The following discussion is close to that in Bourguignon et al. (2007). We repeat it here for ease of reference.

¹⁸The typical element in this vector is $\rho_{x_k u}\sigma_{x_k}$.

$$\sigma_u^2 \cong \frac{\widehat{\sigma}_u^2}{1 - N(\rho_{Xu}\sigma_x)'(X'X)^{-1}(\rho_{Xu}\sigma_x)} \quad (4)$$

We can now substitute (4) in (2) and have the following expression for the bias:

$$B \cong \frac{N(X'X)^{-1}(\rho_{Xu}\sigma_x)\widehat{\sigma}_u}{\left(1 - N(\rho_{Xu}\sigma_x)'(X'X)^{-1}(\rho_{Xu}\sigma_x)\right)^{\frac{1}{2}}} \quad (5)$$

Equation (5) allows us to compute the bias of the OLS estimator for any vector of correlation coefficients $\rho_{Xu}\sigma_x$. Although the correlation coefficients are unknown, they need to range between -1 and 1 . We can thus build bounds for the coefficients of our variables of interest by randomly drawing a large number of correlation coefficients and applying them to equation (5).

In particular, we start with the cross-sectional OLS model of Table 1 column 6 and associate each of our endogenous variables (education, democracy, the interaction between education and democracy, GDP per capita and trade openness) to a random draw from uniform distribution defined over $(0, c)$, substitute these correlations into Equation (5), and use B to recover β . We replicate this exercise 10,000 times for each value of c allowing c to range between -1 and 1 , with increments of 0.1 (for a total of 200,000 simulations). As in Bourguignon et al. (2007), we also impose some restrictions on the values of β . In particular, we drop all draws for which the impact of GDP per capita, Common law, German law, and latitude is non-positive.¹⁹ We then use the remaining observations to look at how the correlation between the endogenous variables and the error term affects the estimation of our variables of interest.

Figure 11 shows how different assumptions about the possible correlation between the error term and each of the endogenous variables affect the coefficient associated with the interaction between democracy and education (the solid line plots the average value and the dashed lines plot the values at the 5th and 95th percentile of the distribution). When we set $\text{corr}=0$ we obtain the same value (0.564) that we obtained with the OLS estimates of Column 6, Table 1. This is not surprising because the OLS estimator assumes $\rho_{Xu} = 0$. The figure also shows that with correlation equal to 0, the whole distribution of the bias collapses to one point.²⁰

The figure also shows that allowing for a negative correlation would strengthen our result of a positive interactive effect between education and democracy.

¹⁹The restrictions are never binding when c ranges between -0.2 and 0.2 , but they exclude most observation when we allow c to take larger values. For instance, when $c = 1$, only 175 draws (out of 10,000) are retained. We think that these restrictions are reasonable and well grounded in the existing literature. However, the results are basically identical if we do not include these restrictions.

²⁰This should clarify the fact that Figure 11 plots the distribution of the corrected estimators obtained with the Monte Carlo simulation and not the sum of the distributions of each corrected estimator.

However, we do not think that this is the likely direction of the bias. It is in fact more likely that our endogenous variables are positively correlated with the error term. The graph shows that the average value of the coefficient for the interaction between democracy and education remains positive if the correlation coefficient is lower than 0.4 and that the coefficient at the bottom 5th percentile of the distribution remains positive if the correlation coefficient is lower than 0.4. Therefore, our results are robust to allowing for a fairly severe endogeneity problem. Moreover, Figure 11 shows that the coefficient at the 95th percentile of the distribution is always positive, indicating that the relationship between the quality of government and the interaction between democracy and education is non-negative even if we assume that our estimation suffer from an extreme endogeneity problem.

We can now look at the marginal effect of democracy on the quality of government. Figure 3, showed that the OLS regressions found a positive effect when average education surpasses 5 years, and a positive and statistically significant effect when average education surpasses 7 years (this is also the mean of the average level of education in our sample). The effect of democracy was instead negative and statistically significant only for countries in which average education is below one year (and in the sample there is only one country with such low level of average education). We find results which are qualitatively and quantitatively similar to those of the OLS regressions if we allow for correlation coefficients which range between -1 and 0.2 (Figure 12). However, we find that that the slopes of the marginal effects become negative and the coefficients are never significant if the correlation between the error term and the endogenous variables is 0.4 or greater.

Next, we look at the marginal effect of education on the quality of government. In Section 3.2 we found that this marginal effect is positively sloped and that the marginal effect is positive when the index of democracy is above 6 and positive and statically significant when the index of democracy is above 7. The marginal effect of education is instead negative when the index of democracy is below 6 and negative and statistically significant when the index of democracy is below 3. Figure 13 plots the marginal effect of education for different values of the democracy index and different assumptions on the correlation between the error term and the endogenous variables. The figure shows that the results are (again) similar to the OLS estimates when the correlations coefficient ranges between -1 and 0.2 .

Summing up, we find that endogeneity would never reverse our results. In the worst case scenario, endogeneity would lead to statistically insignificant estimates of our parameters of interest.

5 A simple model of Politicians Recruitment

This section sketches a simple political selection model that suits the empirical analysis in the paper and illustrates one of the possible channels through which the interplay between the level of democracy and that of education may influence

the quality of government.²¹ We model an economy in which output depends on the type of elected officials and assume that education affect the quality of the signal received by the electorate. In this framework democratic institutions do not guarantee the election of better politicians for low levels of education.²²

5.1 Set-Up

Production and political rents. Consider an economy populated by a continuum of identical individuals. Each individual disposes of an endowment of physical capital, k , used for production purposes. The production technology $f(\cdot)$ is continuous and exhibits positive but decreasing returns on k . The total factor productivity, however, is not constant and depends on the quality of government (q) provided by the party elected in office. We have,

$$y = qf(k) \tag{6}$$

Only part of the capital endowment can be used for production because individuals are subject to the predatory behavior of the ruling party which can expropriate a fraction τ of their endowment. Politicians in turn choose the level of expropriation that maximizes an utility function which includes both aggregate production and the level of expropriation:

$$u_P = \beta y + (1 - \beta)\tau k \tag{7}$$

This simple formulation embodies both kinds of making politics described by Max Weber (1919) in his famous lecture *Politics as a Vocation*. Politicians derive utility (with weight β) from increasing the welfare of their community (and therefore politicians may be seen as partially living a “life [which] has meaning in the service of a cause”) but also (with weight $1 - \beta$) from the pecuniary rents obtained by expropriating the citizens (and therefore by making “politics as a permanent source of income”). Note that we assume that β (a parameter which could be interpreted as capturing a politician’s level of honesty) is independent from q . We therefore assume that all politicians are equally honest (or dishonest). However, we will show that, in equilibrium, high quality politicians will expropriate less than low quality politicians. Therefore, high quality politicians will appear to be more honest than low quality politicians even if, in fact, they have the same preferences.

We can rearrange equation (7) as follows,

$$u_P = \beta qf(\tilde{k}) + (1 - \beta)\tau k \tag{8}$$

²¹The model describes just one of the possible theories consistent with our empirical predictions and has no pretence other than illustration.

²²Our model abstracts from political actions that take place outside the traditional electoral process. Recent work by Campante and Chor (2011) suggests that, by increasing the probability of uprisings, education may provide incentives for good government even in non-democratic regimes.

where, $\tilde{k} = (1 - \tau)k$. This formulation highlights the central trade-off faced by the ruling political party. Direct appropriation of physical capital through expropriation raises the pecuniary component of the utility function but, at the same time, reduces overall production (and social welfare) and, therefore, negatively affects the benevolent component of utility.²³

Political parties. There are only two parties, one incumbent of quality $q \leq q_i \leq \bar{q}$ (which is common knowledge) and one potential entrant whose quality q_e can take any value on the set $q_e \in [q; \bar{q}]$. The type of the potential entrant is realized before the election takes place and is distributed according to a density function $g(q_e) \geq 0$. We assume, however, that the exact realization q_e is private information.

The incumbent can run for a new term at zero cost and therefore will always take part to the electoral competition, independently on the probability of winning. The potential entrant, on the contrary, must decide whether to pay the entry cost c_e and run for office.

Voters. Voters' utility is linear in consumption of the single commodity y . They therefore aim to maximize production and minimize expropriation by trying to select the candidate of highest quality. They observe the quality of the incumbent but not that of the challenger.²⁴

If the challenger is better than the incumbent the voters will observe a positive signal. We assume that the strength of this signal, and thus the probability that the electors will vote for the challenger, is positively correlated with the level of education of the voters E . Formally, a challenger will beat a lower quality incumbent with probability $p(E)$, with

$$\frac{\partial p(E)}{\partial E} > 0.$$

Viceversa, whenever the quality of challenger is lower than that of the incumbent, the voters will observe a positive signal for the challenger with probability $1 - p(E)$. As a break-even rule we also assume that if the two candidates are identical, the incumbent will always win the electoral context. This set of assumptions implies that a qualified candidate has more chances of being elected when the electorate is well educated.²⁵

²³For simplicity, we assumed expropriation of endowments rather than production; assuming predation taking place directly on y jointly with a labor/leisure choice by part of the individuals, or the existence of a formal and an informal sector characterized by different productivities, would deliver the same qualitative results.

²⁴More generally, we need to assume that voters have imperfect information on the difference between the quality of the incumbent and that of the challenger.

²⁵This is in line with the political science literature suggesting that the quality of political participation can affect the quality of political leadership recruited. In poor and uneducated settings ethnic politics tend to prevail (Horowitz, 1985, and Posner et al., 2010) and the electorate tends to exhibit greater preferences for private transfers or clientelism (Huntington and Nelson, 1976, and Finan and Schecter, 2009).

Political regimes. There are two possible political regimes, democracy and oligarchy, which differ only with respect to the barriers to entry into political activity. We assume that under oligarchy political competition is inexistent and potential entrants face prohibitive entry costs, i.e. $c_e \rightarrow \infty$. Under democracy, on the other hand, the entry cost is assumed to be equal to a positive constant $c_e > 0$. This parameter mimics the costs of organizing a political party or sustaining a political campaign in a modern democracy.

This formulation implies that in oligarchic systems the incumbent will always run unchallenged for re-election while political competition can emerge only in democracies.

Timing. The sequence of events and decisions is as follows:

1. The quality of the potential entrant is realized. The potential entrant decides whether to run for office or leave the incumbent unchallenged;
2. If the potential entrant does not run for office the incumbent is re-appointed, otherwise voters observe the signal, elections take place and the winner enters in office;
3. The winning candidate takes the decision regarding expropriation, production takes place and income is realized.

5.2 Entry decision

Preliminaries. We solve the model backward and investigate first the predation decision taken by political parties if elected. Once appointed a political party strikes a balance between predation and production by solving the following maximization problem:

$$\text{Max}_{\tau} u_P = \beta q f(\tilde{k}) + (1 - \beta)\tau k$$

The optimal level of expropriation τ^* is therefore the solution of:

$$f_{\tilde{k}} = \frac{(1 - \beta)}{\beta q}$$

Since, by decreasing returns on physical capital, $f_{\tilde{k}}$ is monotonically decreasing in \tilde{k} and since $\tilde{k} = (1 - \tau)k$, we have:

$$\frac{\partial \tau^*(q, \beta, k)}{\partial q} \leq 0 \quad \forall \beta \in [0, 1] \text{ and } k \in [0, \infty[$$

For any given level of β , an increase in the quality of the political party in office increases the opportunity cost of predation in terms of lost production and therefore reduces politicians' incentives to expropriate the population.²⁶ Other

²⁶The same negative relation between quality of politicians and tax rate emerges if we model the quality of politicians simply as a differential on the propension to benevolent or pecuniary behavior: $u_P = qy + (1 - q)\tau k$, with $q \in [0, 1]$.

things equal, more competent politicians will appear to be more honest than less competent ones (despite sharing the same utility function) because they optimally choose a lower level of expropriation τ .²⁷ In the model, therefore, the quality of politicians has a double positive effect on aggregate production: better governance affects production directly since it raises the total factor productivity, but also indirectly by discouraging predatory behavior.

We are now in a position to study the entry decision. Under democracy, the potential entrant must decide whether to pay the fix cost and run for election or leave the incumbent unchallenged. The solution of this problem depends on the specific realization of q_e . We have to consider separately two different cases, when the entrant's quality is higher than the one of the incumbent, $q_e > q_i$, and viceversa, $q_e \leq q_i$.

(i) High quality entrant. The potential entrant is aware of being of a higher quality than his opponent and knows that he will win the electoral contest, and enjoy the utility described in (??), only if the voters observe the right signal (i.e. with probability $p(E)$). Staying out will conversely entails a null payoff. The potential entrant will therefore decide to challenge the incumbent if and only if the expected utility of entry into politics, net of the entry cost c_e , is greater than zero,

$$E[u_P(\text{entry} \mid q_e > q_i)] = p(E)u_P(q_e, \tau^*(q_e)) - c_e > 0 \quad (9)$$

This entry condition for a high quality potential entrant can be rearranged as follows,

$$p(E) > \frac{c_e}{u_P(q_e, \tau^*(q_e))} \quad (10)$$

Notice that, other things equal, a higher level of education increases the likelihood of having the top quality candidate running for office, this in turn increases the likelihood of observing higher quality of government in equilibrium. Conversely, and quite tautologically, higher barriers to entry discourage political competition.

Notice also that, since $u_P(\cdot)$ is monotonically increasing in q_e (higher quality candidates can always ensure higher payoff by simply replicating the choices of lower quality ones) and since $q_e > q_i$, condition (10) will always hold true independently on the realization of q_e whenever the educational level is such that:

$$p(E) > \frac{c_e}{u_P(q_i, \tau^*(q_i))} \quad (11)$$

²⁷Notice that if we assumed that the quality (q) affects the productivity of politicians in providing public goods (rather than the TFP), the model would predict that more qualified politicians obtain less rents (τ) and provide more public goods. This is in line with the findings of Acemoglu et al. (2011) that document a negative relationship between the relative wages of state employees and the amount of public good provision.

This equation implicitly defines a threshold level of education E_{high}^{In} such that for any $E > E_{high}^{In}$ any potential entrant of higher quality with respect to the incumbent will find it optimal to run for office. Analogously, since $q_e \leq \bar{q}$, condition (10) will fail to hold whenever:

$$p(E) \leq \frac{c_e}{u_P(\bar{q}, \tau^*(\bar{q}))} \quad (12)$$

Equation (12) defines a new threshold level of education $E_{high}^{Out} < E_{high}^{In}$, such that for any $E \leq E_{high}^{Out}$ a potential entrant of higher quality with respect to the incumbent will be better off by not participating in the elections.

These results allow us to characterize the decisions of a high quality challenger independently on the actual realization of q_e .

Lemma 1 *For any $E > E_{high}^{In}$ all candidates of higher quality than the incumbent find it optimal to run for office, while for any $E \leq E_{high}^{In}$ they do not take part in the electoral context. Whenever $E \in [E_{high}^{Out}, E_{high}^{In}]$ the entry decision depends on the specific realization of q_e .*

(ii) Low quality entrant. If the potential entrant is of lower quality than the incumbent, in case of candidature he will win the election only if voters observe the wrong signal (i.e. with probability $1 - p(E)$). Not running for office, on the other hand, will entail a payoff equal to zero. The potential entrant will therefore run for election if and only if:

$$E [u_P(\text{entry} | q_e \leq q_i)] = (1 - p(E))u_P(q_e, \tau^*(q_e)) - c_e > 0 \quad (13)$$

The entry condition reads therefore as follows,

$$p(E) < 1 - \frac{c_e}{u_P(q_e, \tau^*(q_e))} \quad (14)$$

When the potential entrant is of lower quality, education discourages entry because it decreases the likelihood of a wrong decision by part of the voters. Notice that, since $u_P(\cdot)$ is monotonically increasing in q_e and since $q_e > \underline{q}$, condition (14) is always verified (i.e. independently on the actual realization of q_e) when education is such that

$$p(E) < 1 - \frac{c_e}{u_P(\underline{q}, \tau^*(\underline{q}))} \quad (15)$$

This equation implicitly defines a threshold level of education E_{low}^{In} such that for any $E \leq E_{low}^{In}$ potential entrants of lower quality than the incumbent will always find it optimal to run for office. Furthermore, since $q_e < q_i$, condition (14) will fail to hold whenever:

$$p(E) > 1 - \frac{c_e}{u_P(q_i, \tau^*(q_i))} \quad (16)$$

This equation defines a fourth threshold level on education $E_{low}^{Out} > E_{low}^{In}$ such that for any $E \geq E_{low}^{Out}$ any potential entrant of lower quality than the incumbent will not run for office. Therefore,

Lemma 2 *For any $E < E_{low}^{In}$ all candidates of lower quality than the incumbent find it optimal to run for office, while for any $E \geq E_{low}^{Out}$ they decide to stay out from the electoral process. Whenever $E \in [E_{low}^{In}, E_{low}^{Out}]$, the entry decision depends on the specific realization of q_e .*

For the sake of expositional simplicity, but without any loss of generality, we assume that c_e is such that $E_{high}^{Out} > E_{low}^{Out}$ and therefore $E_{high}^{In} > E_{high}^{Out} > E_{low}^{Out} > E_{low}^{In}$.²⁸

5.3 Politicians Recruitment, Education and Governance

We now conduct a comparative statics exercise aimed at comparing the impact of different political institutions on the quality of elected officials, and the way in which these institutions interact with education in determining electoral outcomes.

From conditions (15) and (16) we know that for very low levels of education only potential entrants of quality lower than the incumbent find it optimal to run for office. In this context, imposing prohibitive barriers to entry will raise the average quality of government by discouraging low quality candidates from trying to overthrow high quality incumbents. In well educated countries, instead, only the decisions of potential entrants of quality higher than the incumbent will be affected by changes in the political regime. More democratic and open institutions, in this case, will encourage the best candidates to run for office thereby raising the average quality of government. Formally, we have the following:

Proposition 3 *The level of education affects the comparison between democratic and oligarchic systems in terms of selection of the politicians:*

(i) *For any $E > E_{high}^{In}$ a democracy is associated with a higher expected quality of elected officials (and lower expropriation) than an oligarchic system;*

(ii) *For any $E < E_{low}^{In}$ an oligarchic system is associated with a higher expected quality of elected officials (and lower expropriation) as compared with a democracy;*

(iii) *For any $E \in [E_{low}^{In}, E_{high}^{In}]$ it is impossible to make a comparison between the two systems.*

Proof. *First consider $E > E_{high}^{In}$. Under democracy, by Lemmata 1 and 2, and since $E_{high}^{In} > E_{low}^{Out}$, only potential entrants of quality $q_e \in]q_i, \bar{q}]$ will run for office. Therefore,*

²⁸This essentially entails a cost of entry c_e sufficiently high.

$$E(QoG | democracy) = \int_{\underline{q}}^{q_i} q_i dg(q_e) + \int_{q_i}^{\bar{q}} [p(E)q_e + (1 - p(E))q_i] dg(q_e)$$

Under oligarchy the incumbent will always run unchallenged implying

$$E(QoG | oligarchy) = \int_{\underline{q}}^{\bar{q}} q_i dg(q_e) = q_i$$

The result (i) follows since $\int_{q_i}^{\bar{q}} q_e dg(q_e) > \int_{q_i}^{\bar{q}} q_i = q_i$ and since higher quality elected officials optimally impose a lower τ^* .

Next, consider $E < E_{low}^{In}$. In this region by Lemmata 1 and 2, and since $E_{high}^{Out} > E_{low}^{In}$, we have that under democracy only potential entrants of quality $q_e \in]\underline{q}, q_i]$ will participate to the elections. Thus

$$E(QoG | democracy) = \int_{\underline{q}}^{q_i} [p(E)q_i + (1 - p(E))q_e] dg(q_e) + \int_{q_i}^{\bar{q}} q_i dg(q_e)$$

In oligarchy the incumbent will always run unchallenged implying

$$E(QoG | oligarchy) = \int_{\underline{q}}^{\bar{q}} q_i dg(q_e) = q_i$$

Result (ii) follows since $\int_{\underline{q}}^{q_i} q_e dg(q_e) < \int_{\underline{q}}^{q_i} q_i = q_i$ and since lower quality elected officials optimally impose a higher τ^* .

Finally consider $E \in [E_{low}^{In}, E_{high}^{In}]$. In this intermediate area both high and low quality candidates may decide to run for office (or not) depending on the specific realization of q_e . It is therefore impossible to make a comparison between the expected quality of government in the two systems.

Notice that result (ii) in Proposition 3 relies on the characteristics of the probability function employed in the model and in particular on the absence of a lower bound on $p(E)$. This, in fact, implies that when educational level is very low, low quality entrants have greater probability of getting a good signal than a high quality ones. Imposing a lower bound on probability in order to avoid a systematic bias against the right choice in uneducated polities would not reverse our predictions but result in a neutral (rather than negative) effect of political institutions on the quality of government for low educational levels.

6 Conclusions

This paper contributes to the vast literature on the functioning of democratic institutions. We look at how the interplay between education and democracy affect the quality of government. In doing so, we synthesize recent research that highlights the importance of political institutions as a fundamental factor explaining cross-country differences in income per capita with work that argues that institutional improvements and development are ultimately driven by social and human capital.

We provide evidence corroborating the idea that the success or failure of democratic institutions is ultimately linked to the spread of education throughout the population. In particular, we show that: (i) the interaction between democracy and education is always a positively and significantly correlated with the quality of government; (ii) the correlation between democracy and quality of government is statistically significant only in countries with high levels of education; and (iii) that the marginal effect of education is positive and statistically significant in countries with high levels of democracy. We also run a set of Monte Carlo simulations which show that our results are not driven by reverse causality.

Overall, we see the results and analysis presented in the paper reinforcing the observation that democratic institutions per se do not guarantee effective government and that democracy is more likely to flourish when certain social and economic preconditions generally linked to education are satisfied. We are unable, however, to decompose the effect of education on quality of government into problems of civic culture, selection or incentives whose relative importance is likely to change from country to country. We leave this exploration to further research.

7 References

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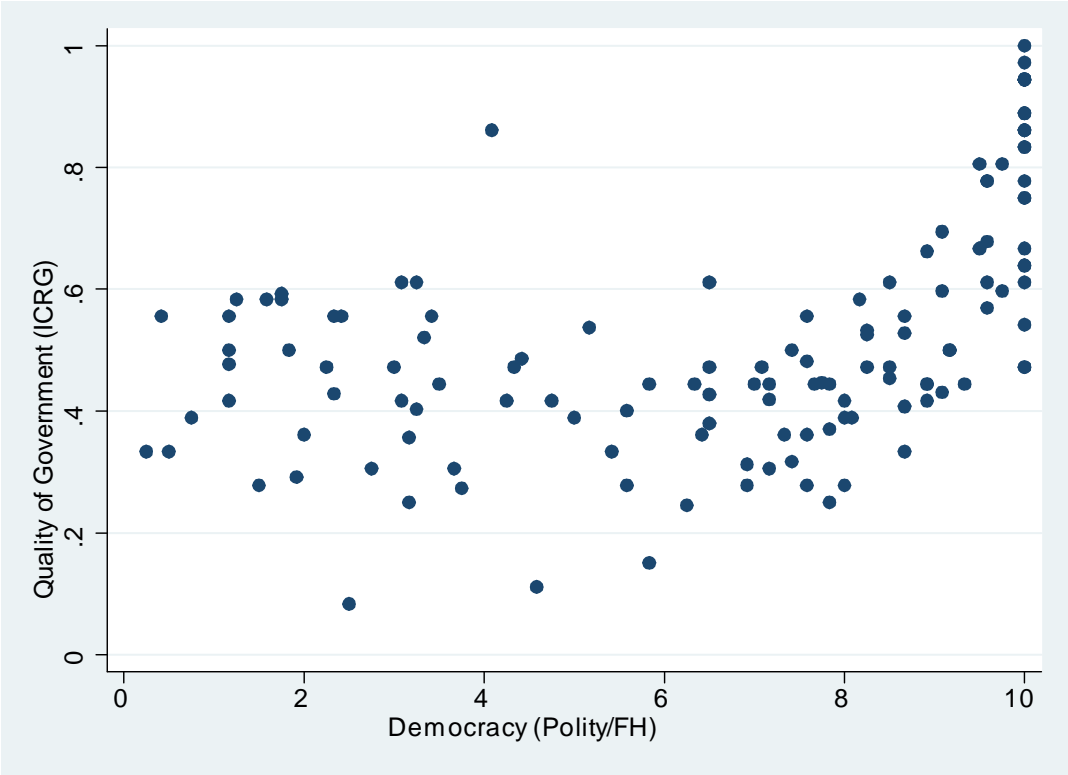


Figure 1. Democracy and Quality of Government.

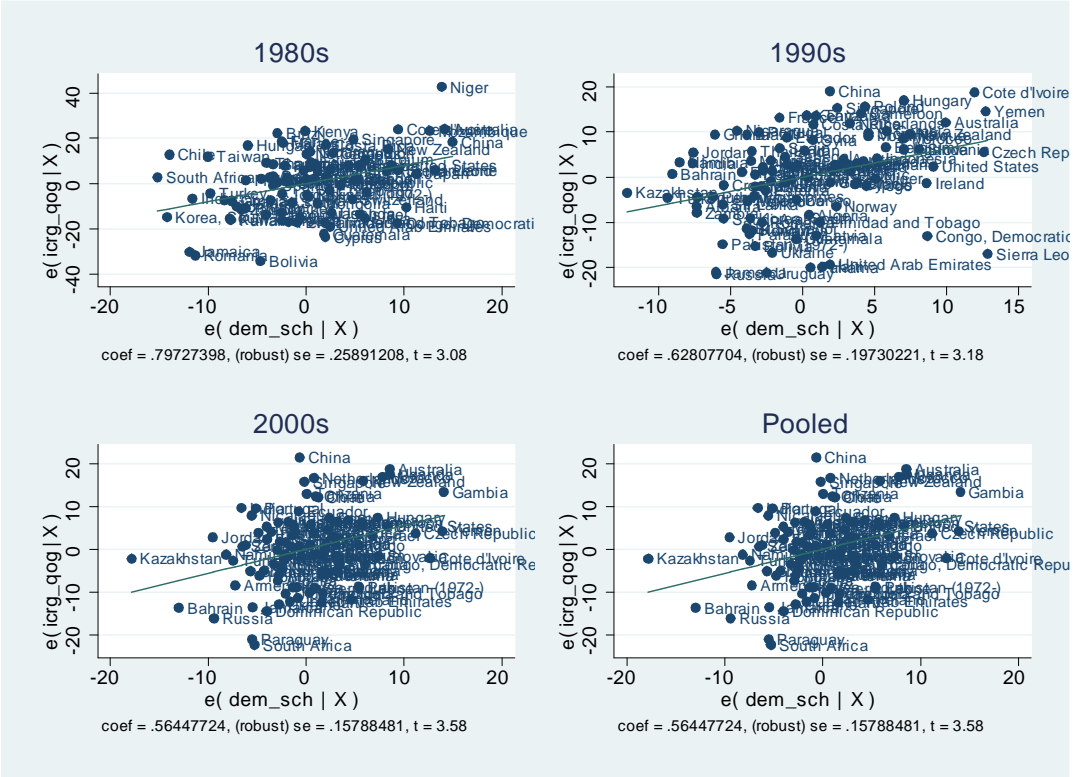


Figure 2. Partial correlation plots.

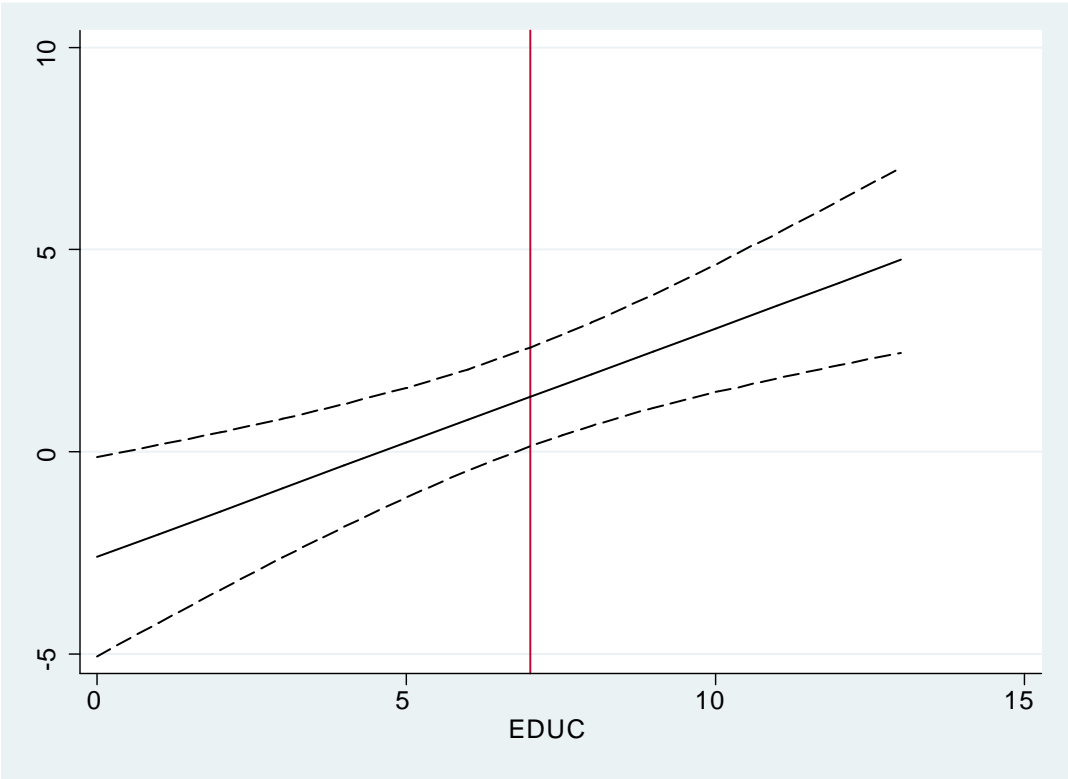


Figure 3. $\partial QOG/\partial DEM$, cross country regressions, year 2000.

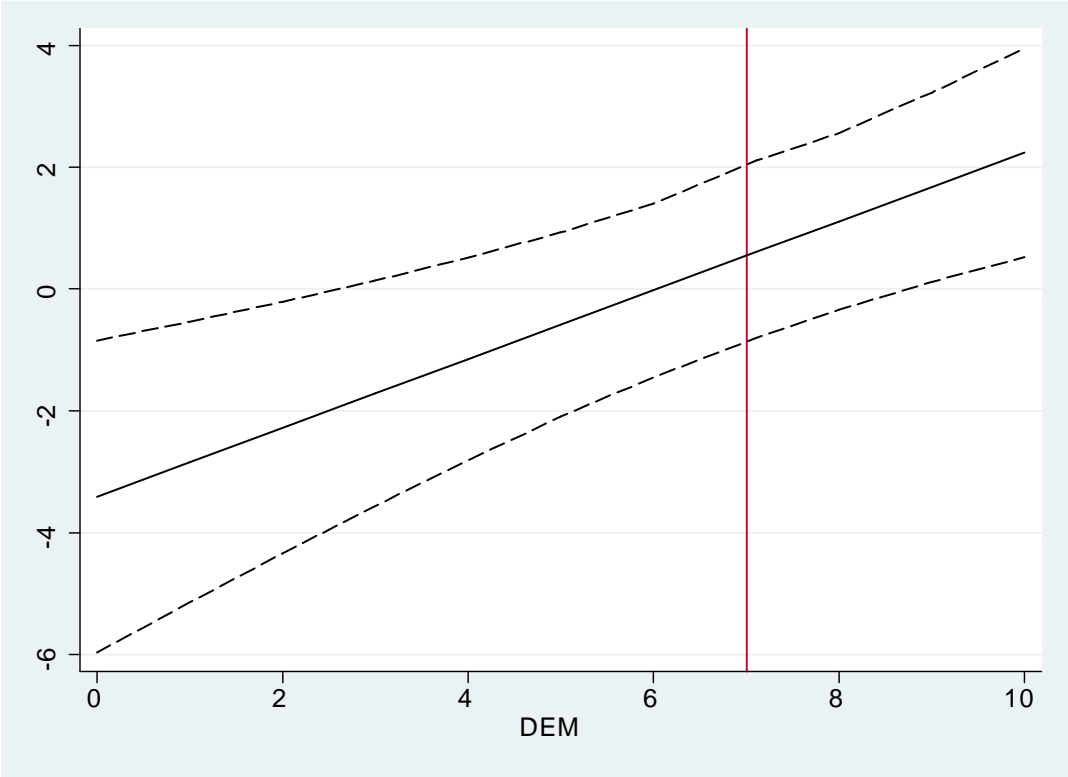


Figure 4. $\partial QOG/\partial EDUC$, cross country regressions, year 2000.

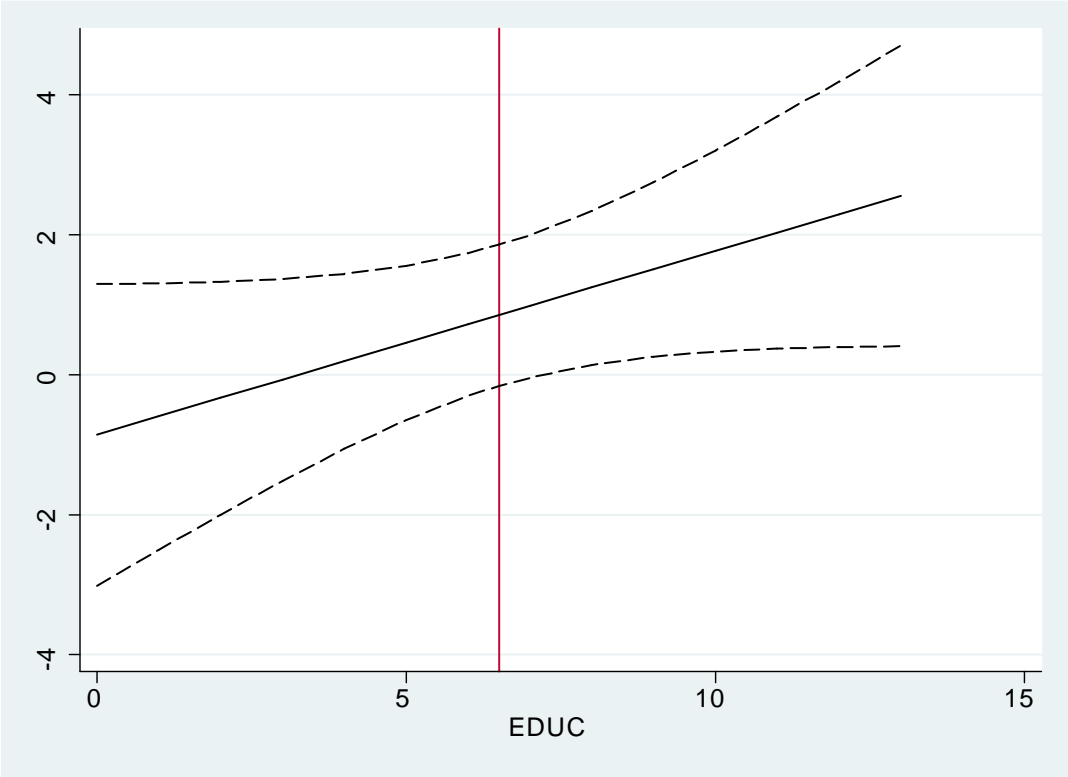


Figure 5. $\partial QOG/\partial DEM$, Fixed effects panel regression, 10-year.

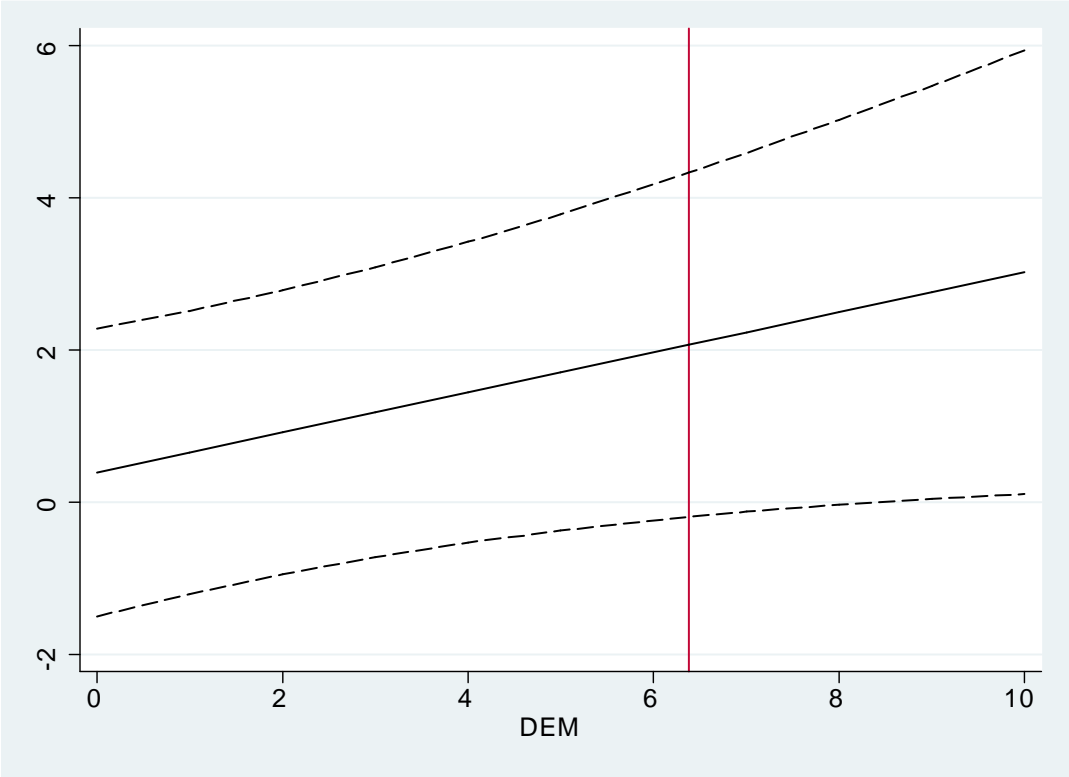


Figure 6. $\partial QOG/\partial EDUC$, Fixed effects panel regression, 10-year.

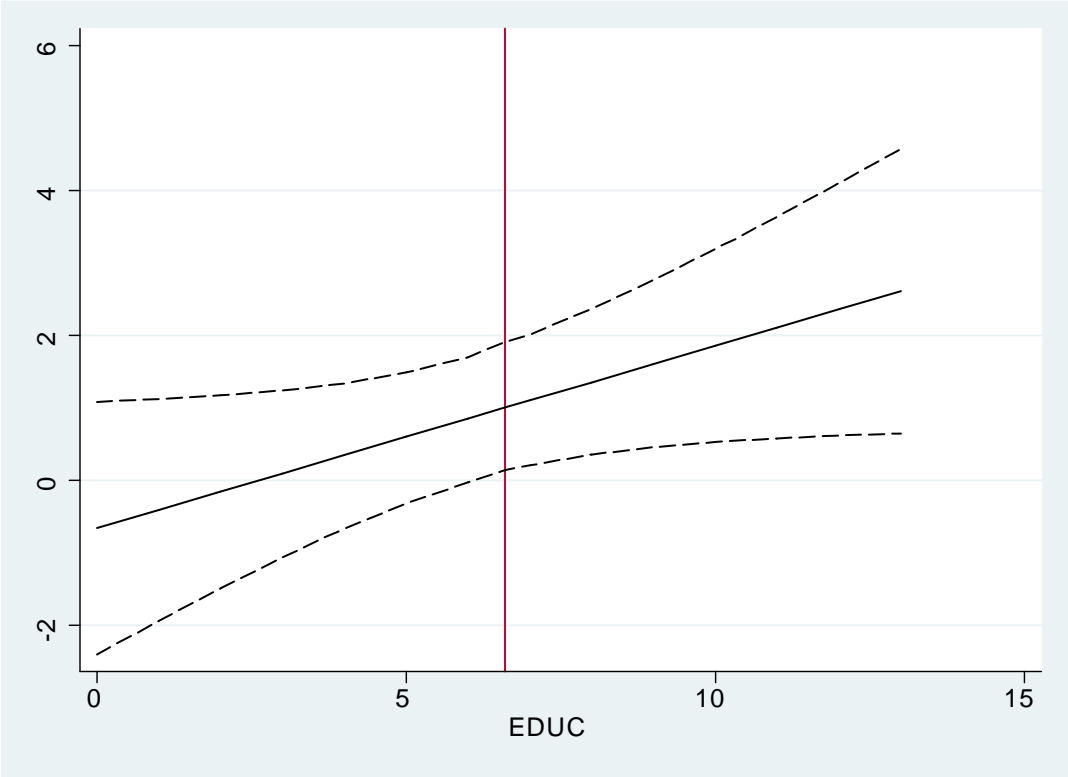


Figure 7. $\partial QOG/\partial DEM$, Fixed effects panel regression, 5-year.

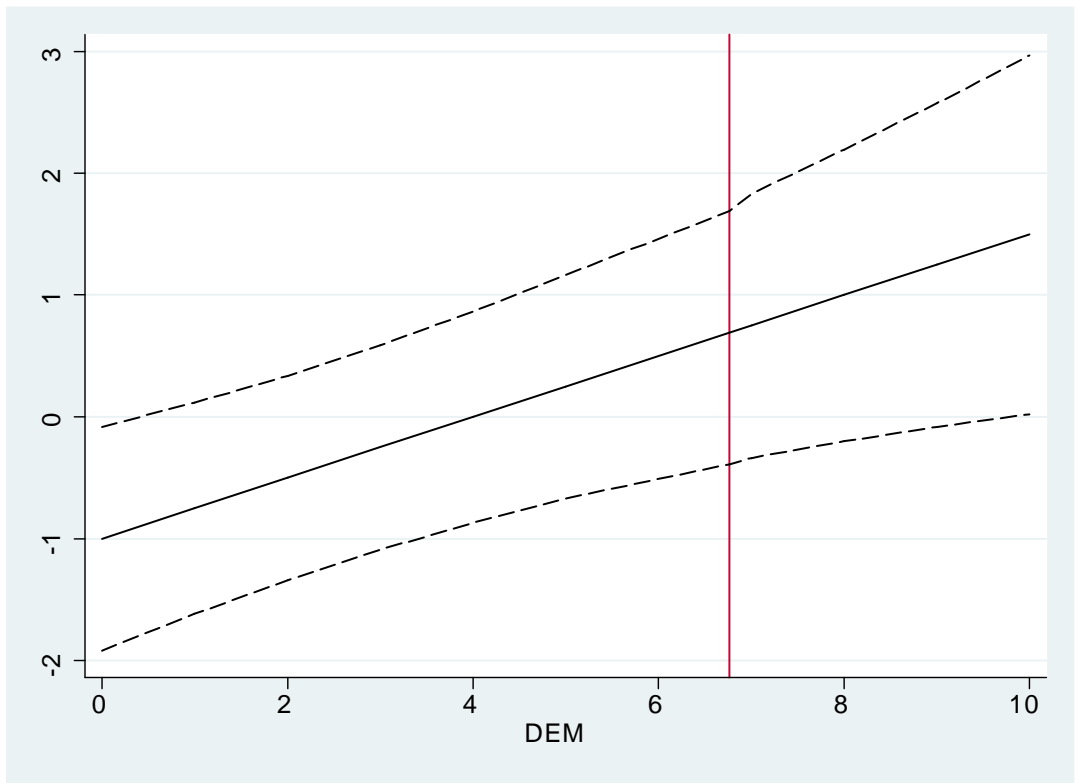


Figure 8. $\partial QOG/\partial EDUC$, Fixed effects panel regression, 5-year.

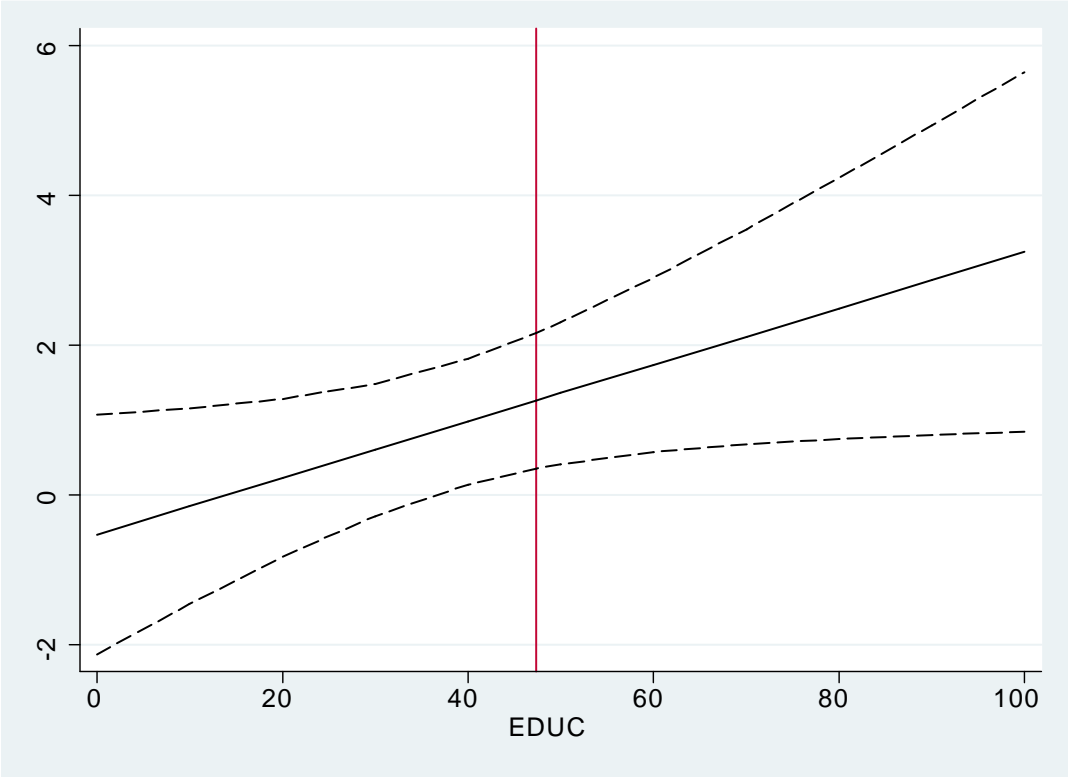


Figure 9. $\partial QOG/\partial DEM$, Fixed effects panel regression, 1-year.

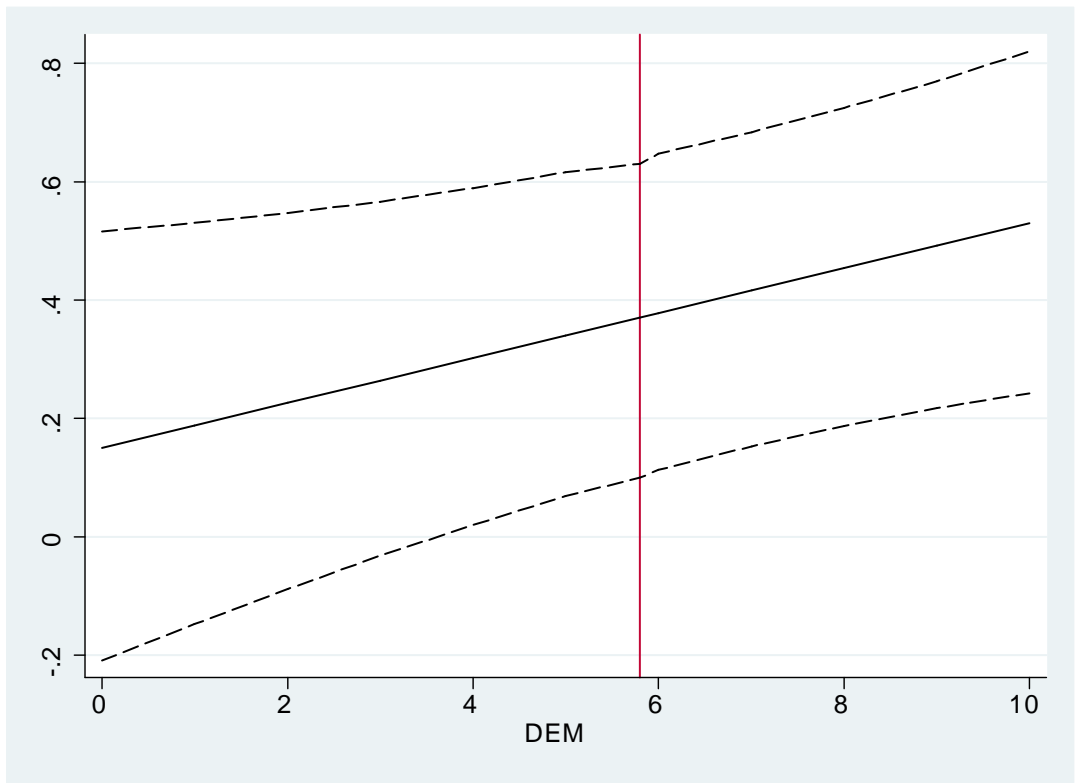


Figure 10. $\partial QOG/\partial EDUC$, Fixed effects panel regression, 1-year.

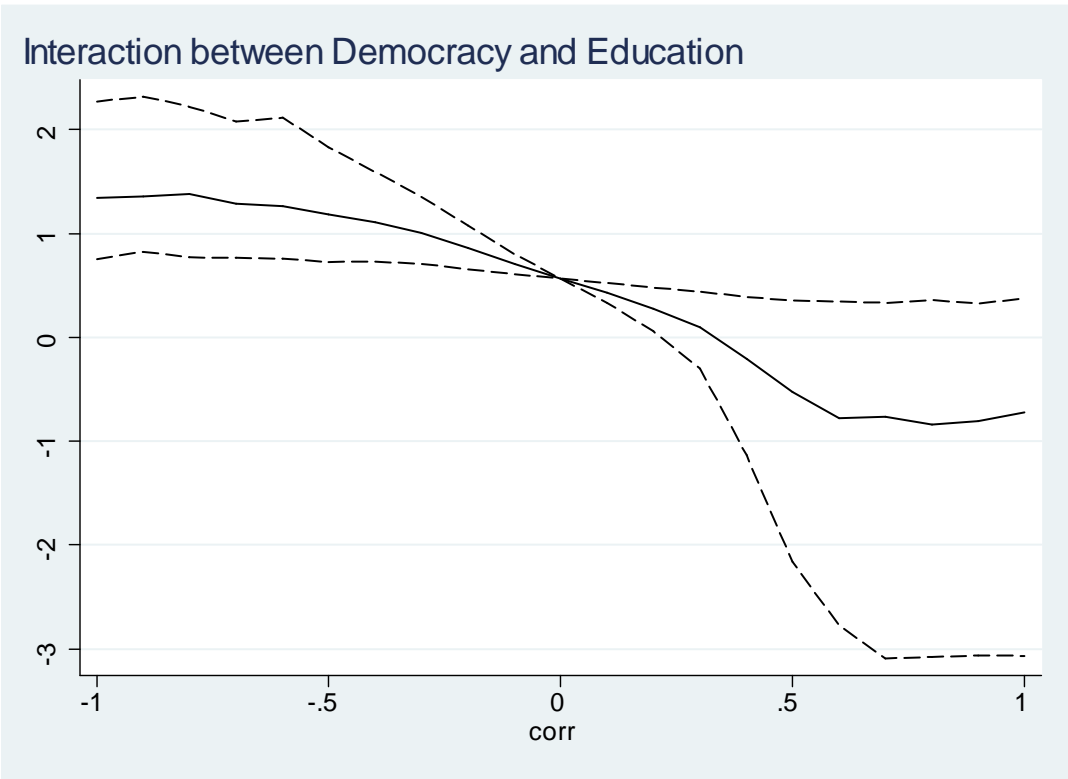


Figure 11.

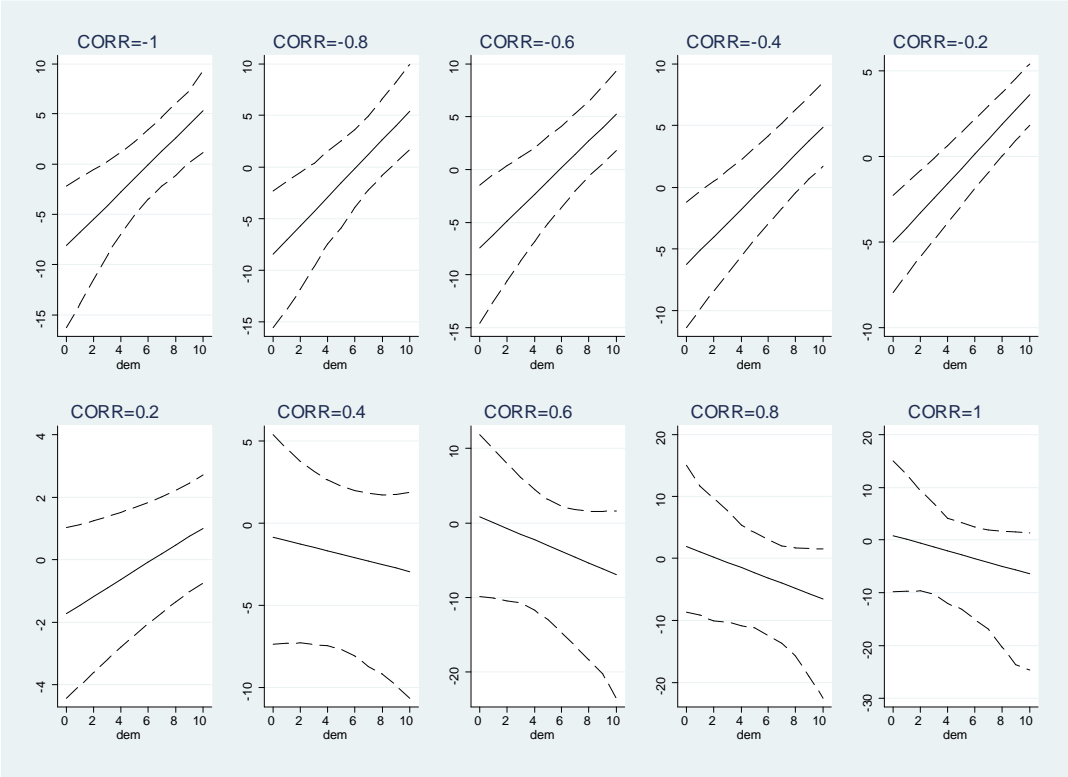


Figure 12.

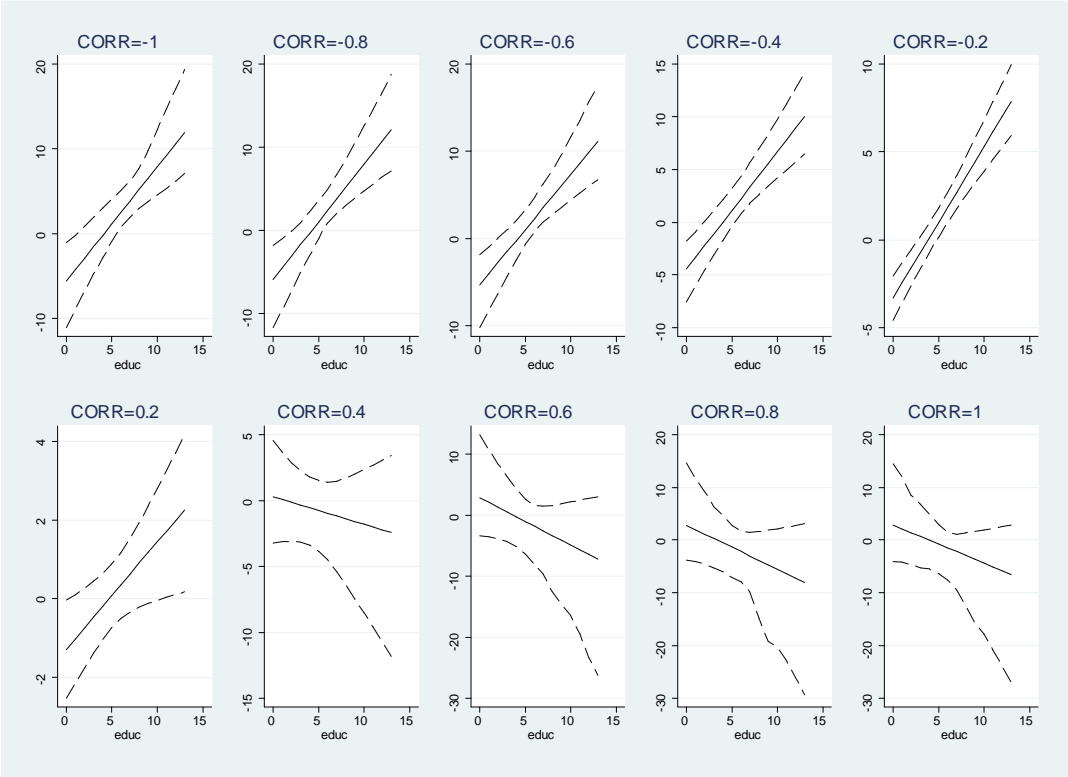


Figure 13.

Dependent variable: Quality of Government						
	(1)	(2)	(3)	(4)	(5)	(6)
	1980s		1990s		2000s	
DEMOC	2.832*** (0.78)	3.260*** (0.79)	1.188 (0.76)	1.661** (0.70)	1.245* (0.63)	1.652*** (0.63)
EDUC	-0.46 (1.41)	-1.684 (1.35)	0.577 (0.89)	0.00494 (0.94)	0.834 (0.71)	0.606 (0.71)
DEM*EDUC		0.797*** (0.26)		0.628*** (0.20)		0.564*** (0.16)
OPEN	0.0637 (0.05)	0.0777* (0.04)	0.0241 (0.03)	0.0362 (0.03)	0.0575* (0.03)	0.0592** (0.03)
ln(GDP PC)	7.972** (3.08)	8.854*** (3.01)	6.389*** (2.00)	7.271*** (2.06)	5.274*** (1.58)	6.294*** (1.62)
ELF	22.01** (9.36)	19.39** (8.35)	0.742 (6.43)	1.221 (5.68)	3.895 (4.99)	5.279 (4.68)
COMMON LAW	-3.017 (11.61)	-18.78* (11.26)	14.11*** (4.43)	10.02** (4.26)	22.89*** (4.05)	19.77*** (4.15)
FRENCH LAW	-3.673 (11.30)	-21.28* (11.01)	7.145 (5.51)	2.642 (5.33)	11.90*** (4.27)	9.029** (4.24)
GERMAN LAW	9.037 (12.29)	-4.954 (11.47)	16.58*** (5.39)	12.58** (4.83)	23.14*** (4.52)	19.17*** (4.45)
SCAND. LAW	-6.176 (20.20)	-11.55 (18.07)	10.55 (8.10)	8.476 (7.20)	30.80*** (7.49)	30.47*** (7.29)
CATHOLIC	-0.129* (0.07)	-0.0925 (0.06)	-0.0371 (0.04)	-0.0253 (0.04)	0.0467 (0.04)	0.0395 (0.04)
PROTESTANT	0.144 (0.19)	-0.0207 (0.18)	0.0779 (0.08)	0.0289 (0.08)	-0.00877 (0.07)	-0.0568 (0.07)
MUSLIM	-0.0662 (0.08)	-0.0702 (0.07)	-0.00809 (0.07)	-0.0222 (0.06)	0.0549 (0.06)	0.0427 (0.05)
abs(Latitude)	42.24*** (14.92)	31.91** (13.77)	37.82*** (9.84)	32.18*** (9.24)	44.88*** (8.72)	36.91*** (8.97)
Constant	-46.68** (21.04)	-27.44 (23.98)	-28.47** (13.81)	-23.54 (15.56)	-44.91*** (11.13)	-36.29*** (11.82)
Observations	88	88	104	104	106	106
R-squared	0.683	0.728	0.77	0.797	0.823	0.844
DEMO+1SD*SCH		5.652		3.545		3.346
p value		0.00		0.00		0.00
DEMO-1SD*SCH		0.868		-0.223		-0.041
p value		0.361		0.81		0.954
SCH+1SDEMOC		0.708		1.889		2.30
p value		0.586		0.036		0.01
SCH-1SDEMOC		-4.076		-1.879		-1.087
p value		0.025		0.151		0.192

Table 1: Cross-country OLS regressions

Dependent variable: Quality of Government					
	(1)	(2)	(3)	(4)	(5)
	Alternative measure of education		Robust regressions		
	1980s	1990s	1980s	1990s	2000s
DEMOC	3.058*** (0.66)	1.270** (0.61)	3.410*** (0.89)	1.641** (0.70)	2.019*** (0.55)
EDUC1	-0.178 (0.12)	0.0267 (0.09)			
DEM*EDUC1	0.103*** (0.02)	0.0490** (0.02)			
EDUC			-1.878 (1.47)	-0.818 (0.88)	0.821 (0.73)
DEM*EDUC1			0.762*** (0.26)	0.764*** (0.19)	0.531*** (0.17)
OPEN	0.0649 (0.05)	0.0106 (0.03)	0.0785* (0.05)	0.0383 (0.03)	0.0536** (0.02)
ln(GDP PC)	8.707*** (2.19)	9.276*** (1.71)	9.515*** (3.02)	8.304*** (1.87)	5.612*** (1.62)
ELF	18.27** (8.26)	0.0596 (5.51)	19.61** (9.06)	0.602 (5.20)	7.179 (4.47)
COMMON LAW	-22.51*** (7.60)	4.608 (4.28)	-19.64 (12.51)	9.313* (5.19)	21.07*** (4.32)
FRENCH LAW	-22.03*** (7.22)	0.826 (4.75)	-22.49* (12.33)	0.28 (5.39)	10.09** (4.47)
GERMAN LAW	-13.26* (6.81)	7.521 (4.85)	-7.76 (12.71)	10.36 (6.30)	20.76*** (5.31)
SCAND. LAW	-22.83* (13.55)	0.445 (7.46)	-15.34 (19.14)	6.246 (9.20)	31.70*** (8.08)
CATHOLIC	-0.106* (0.06)	-0.0655* (0.04)	-0.0954 (0.08)	-0.0224 (0.04)	0.0559 (0.04)
PROTESTANT	0.0818 (0.14)	0.111 (0.08)	0.00408 (0.17)	0.0321 (0.08)	-0.0504 (0.07)
MUSLIM	-0.0801 (0.07)	-0.0452 (0.05)	-0.0795 (0.09)	-0.0451 (0.06)	0.0771 (0.05)
abs(Latitude)	28.46** (12.82)	20.18* (10.69)	31.63* (17.35)	31.51*** (11.03)	38.88*** (9.56)
Constant	-23.88 (16.97)	-31.19** (13.66)	-31.61 (24.80)	-30.25** (14.44)	-33.57*** (12.66)
Observations	109	127	88	104	106
R-squared	0.708	0.773	0.684	0.775	0.834

Table 2: Cross-country regressions: Sensitivity Analysis

Dependent variable: Quality of Government				
	(1)	(2)	(3)	(4)
	Random effects		Fixed effects	
DEMOC	1.121** (0.45)	1.337*** (0.42)	0.708 (0.57)	0.846* (0.51)
EDUC	0.935 (0.71)	0.932 (0.71)	1.871 (1.52)	2.068 (1.47)
DEM*EDUC		0.288** (0.13)		0.263* (0.15)
OPEN	0.0342 (0.03)	0.0371 (0.04)	-0.0217 (0.06)	-0.0257 (0.06)
ln(GDP PC)	6.037*** (1.55)	5.743*** (1.56)	3.781 (3.29)	0.44 (3.35)
ELF	6.061 (5.80)	5.813 (5.45)		
COMMON LAW	18.14*** (4.18)	17.06*** (4.11)		
FRENCH LAW	10.54** (4.97)	9.172* (4.73)		
GERMAN LAW	21.78*** (5.32)	20.61*** (4.94)		
SCAND. LAW	21.24*** (7.93)	22.32*** (7.62)		
CATHOLIC	-0.0128 (0.04)	-0.0073 (0.04)		
PROTESTANT	0.0466 (0.08)	0.00824 (0.08)		
MUSLIM	0.0052 (0.05)	0.00705 (0.05)		
abs(Latitude)	40.55*** (8.92)	37.72*** (8.73)		
Constant	-44.38*** (11.40)	-28.25** (11.80)	8.899 (30.73)	53.42* (28.31)
Observations	298	298	304	304
R-squared			0.189	0.212
Number of countries	106	106	109	109

Table 3: Panel data regressions: 10-year periods

Dependent variable: Quality of Government				
	(1)	(2)	(3)	(4)
	Random effects		Fixed effects	
DEMOC	0.871** (0.436)	1.247*** (0.368)	0.694 (0.512)	1.024** (0.445)
EDUC	0.585 (0.678)	0.601 (0.671)	0.649 (1.378)	0.646 (1.332)
DEM*EDUC		0.292*** (0.109)		0.250* (0.126)
OPEN	0.0135 (0.033)	0.0177 (0.034)	-0.0459 (0.048)	-0.0481 (0.047)
ln(GDP PC)	6.891*** (1.419)	6.503*** (1.416)	5.979* (3.021)	3.729 (2.945)
ELF	3.971 (5.533)	3.93 (5.146)		
COMMON LAW	17.75*** (3.933)	16.41*** (3.837)		
FRENCH LAW	8.755* (4.670)	7.257 (4.468)		
GERMAN LAW	19.82*** (4.850)	18.58*** (4.564)		
SCAND. LAW	19.76*** (7.579)	20.52*** (7.351)		
CATHOLIC	0.00309 (0.037)	0.00778 (0.035)		
PROTESTANT	0.0537 (0.077)	0.0187 (0.074)		
MUSLIM	0.000656 (0.048)	0.00917 (0.045)		
abs(Latitude)	39.65*** (8.710)	36.20*** (8.475)		
Constant	-40.59*** (11.010)	-27.29** (11.590)	-2.276 (28.130)	24.93 (25.210)
Observations	488	488	496	496
R-squared			0.19	0.209
Number of countries	106	106	109	109

Table 4: Panel data regressions: 5-year periods

Dependent variable: Quality of Government				
	(1)	(2)	(3)	(4)
	Random effects		Fixed effects	
DEMOC	1.120*** (0.430)		1.006** (0.452)	1.256*** (0.459)
EDUC	0.233** (0.115)		0.329** (0.141)	0.365*** (0.136)
DEM*EDUC		0.0413** (0.017)		0.0378** (0.018)
OPEN	0.0457** (0.020)	0.0420** (0.020)	0.0584** (0.025)	0.0523** (0.023)
ln(GDP PC)	7.340*** (1.834)	6.498*** (1.755)	7.285** (3.033)	5.998** (2.913)
ELF	7.341 (6.183)	6.226 (5.991)		
COMMON LAW	7.594* (4.569)	4.244 (4.690)		
FRENCH LAW	4.289 (4.437)	0.871 (4.516)		
GERMAN LAW	12.33** (5.578)	8.737 (5.315)		
SCAND. LAW	5.795 (8.118)	1.769 (8.383)		
CATHOLIC	-0.0742* (0.040)	-0.0752* (0.040)		
PROTESTANT	0.133 (0.086)	0.13 (0.091)		
MUSLIM	-0.0171 (0.049)	0.00251 (0.049)		
abs(Latitude)	24.52** (10.750)	18.10* (10.800)		
Constant	-42.29*** (13.560)	-14.56 (14.080)	-32.1 (25.920)	-1.247 (24.710)
Observations	1925	1925	1943	1943
R-squared			0.11	0.128
Number of countries	127	127	129	129

Table 5: Panel data regressions: annual data

Dependent variable: Quality of Government				
	(1)	(2)	(3)	(4)
	RE	RE, IV	FE	FE, IV
DEMOC	1.587*** (0.156)	1.721*** (0.293)	1.480*** (0.161)	1.669*** (0.310)
EDUC	0.451*** (0.047)	0.411*** (0.080)	0.518*** (0.052)	0.481*** (0.078)
DEM*EDUC	0.0412*** (0.006)	0.0443*** (0.008)	0.0359*** (0.007)	0.0397*** (0.009)
OPEN	0.0525*** (0.015)	0.0224 (0.058)	0.0599*** (0.018)	0.0136 (0.064)
GROWTH	9.601** (4.330)	17.4 (205.800)	8.829** (4.308)	14.7 (137.400)
ELF	4.661 (5.715)	7.476 (8.016)		
COMMON LAW	11.28** (4.762)	10.80** (4.986)		
FRENCH LAW	4.721 (4.858)	4.89 (5.056)		
GERMAN LAW	18.86*** (6.700)	17.71** (7.144)		
SCAND. LAW	12.01 (10.700)	10.37 (11.310)		
CATHOLIC	-0.0366 (0.050)	-0.0323 (0.053)		
PROTESTANT	0.0916 (0.101)	0.117 (0.116)		
MUSLIM	0.0584 (0.052)	0.0599 (0.055)		
abs(Latitude)	29.93*** (9.753)	29.25*** (10.510)		
Constant	31.18*** (6.680)	30.50*** (7.087)	50.99*** (1.229)	52.72*** (2.675)
Observations	1667	1667	1683	1683
Number of countries	116	116	118	118
R-squared			0.153	

Table 6: Panel data regressions, instrumenting GDP growth

Dependent variable: Quality of Government			
	(1)	(2)	(3)
	DIF-GMM	SYS-GMM	SYS-GMM
L.QOG	1.142*** (0.029)	1.152*** (0.029)	1.145*** (0.030)
L2.QOG	-0.323*** (0.026)	-0.312*** (0.025)	-0.313*** (0.025)
DEMOC	0.318** (0.126)	0.403*** (0.115)	0.392*** (0.133)
DEM*EDUC	0.00703* (0.004)	0.00354 (0.004)	0.0038 (0.004)
EDUC	0.0779** (0.032)	0.0786*** (0.021)	0.0648** (0.028)
OPEN	-0.00143 (0.011)	0.0033 (0.008)	-1.76E-05 (0.010)
ln(GDP PC)	1.045 (0.851)	0.269* (0.143)	0.972 (0.683)
ELF			-0.618 (4.519)
COMMON LAW			0.177 (4.286)
FRENCH LAW			0.0592 (4.306)
GERMAN LAW			-6.057 (5.937)
SCAND. LAW			-3.501 (10.790)
CATHOLIC			-0.0491 (0.032)
PROTESTANT			-0.0148 (0.098)
MUSLIM			-0.0633* (0.034)
abs(Latitude)			-2.498 (9.048)
Observations	1455	1574	1561
Number of countries	118	118	117
AR1 test (pvalue)	0.00	0.00	0.00
AR2 test (pvalue)	0.16	0.13	0.12
Sargan test (pvalue)	0.12	0.02	0.02

Table 7: Panel data regressions, dynamic panel

	Obs	Mean	Std. Dev.	Min	Max
1980s					
QOG	109	51.65	25.02	5.56	100
DEMOC	109	4.79	3.49	0.25	10
EDUC	88	5.15	2.85	0.5	12.04
EDUC1	109	42.81	21.6	3.5	99.5
OPEN	109	64.77	44.57	13.11	359.98
ln(GDP PC)	109	8.54	1.1	6.34	10.85
1990s					
QOG	127	57.9	20.96	10.65	100
DEMOC	127	6.07	3.03	0.08	10
EDUC	106	7.53	2.83	0.98	12.73
EDUC1	127	50.81	21.14	9.5	99.5
OPEN	127	72.4	41.5	2.95	337.88
ln(GDP PC)	127	8.62	1.15	5.73	10.59
2000s					
QOG	106	55.48	20.28	11.11	100
DEMOC	106	7.11	2.83	0.19	10
EDUC	106	7.53	2.83	0.98	12.73
OPEN	106	86.24	47.39	25.14	407.64
ln(GDP PC)	106	8.98	1.15	5.89	10.7
Variables with no time variation					
ELF	127	0.47	0.27	0	1
COMMON LAW	127	0.3	0.46	0	1
FRENCH LAW	127	0.45	0.5	0	1
GERMAN LAW	127	0.05	0.21	0	1
SCAND. LAW	127	0.03	0.18	0	1
CATHOLIC	127	31.25	36.1	0	96.9
PROTESTANT	127	11.69	20.31	0	97.8
MUSLIM	127	24.17	36.56	0	99.8
abs(Latitude)	127	0.3	0.19	0	0.71

Table 8: Summary statistics for cross-country estimates

Variable		Mean	Std. Dev.	Min	Max	Observations
10-year panel						
QOG	overall	57.36	21.8	9.1	100	N = 304
	between		20.38	12.13	99.85	n = 109
	within		7.29	35.52	83.44	T-bar = 2.79
DEMOC	overall	6.38	3.17	0.08	10	N = 304
	between		2.85	0.24	10	n = 109
	within		1.29	1.15	9.68	T-bar = 2.79
EDUC	overall	6.5	2.97	0.44	12.73	N = 304
	between		2.87	0.82	12.38	n = 109
	within		0.91	4.37	8.72	T-bar = 2.79
OPEN	overall	75.63	44.92	13.11	407.64	N = 304
	between		42.54	19.98	368.5	n = 109
	within		12.34	22.24	120.2	T-bar = 2.79
ln(GDP PC)	overall	8.88	1.1	5.89	11.13	N = 304
	between		1.09	6.02	10.94	n = 109
	within		0.19	8.2	9.56	T-bar = 2.79
5-year panel						
QOG	overall	58.13	21.61	9.81	100	N = 496
	between		20.02	12.5	99.82	n = 109
	within		7.27	34.99	89.38	T-bar = 4.55
DEMOC	overall	6.6	3.11	0	10	N = 496
	between		2.87	0.2	10	n = 109
	within		1.17	0.31	10.15	T-bar = 4.55
EDUC	overall	6.76	2.94	0.28	13.09	N = 496
	between		2.87	0.88	12.47	n = 109
	within		0.79	4.56	8.95	T-bar = 4.55
OPEN	overall	76.75	45.69	12.63	443.23	N = 496
	between		42.87	20.27	369.47	n = 109
	within		13.34	15.55	150.52	T-bar = 4.55
ln(GDP PC)	overall	8.9	1.12	5.87	11.03	N = 496
	between		1.1	6	10.82	n = 109
	within		0.18	8.18	9.63	T-bar = 4.55
Annual panel						
QOG	overall	55.76	23.59	4.17	100	N = 1943
	between		21.15	12.83	100	n = 129
	within		9.1	25.15	89.44	T-bar = 15.06
DEMOC	overall	5.58	3.43	0	10	N = 1943
	between		3.09	0.22	10	n = 129
	within		1.45	-0.14	10.87	T-bar = 15.06
EDUC1	overall	47.39	21.63	3.5	99.5	N = 1943
	between		20.96	8.19	99.5	n = 129
	within		4.31	34.15	56.65	T-bar = 15.06
OPEN	overall	67.89	44.26	1.98	376.3	N = 1943
	between		40.76	9.97	338.39	n = 129
	within		16.12	-68.6	246.59	T-bar = 15.06
ln(GDP PC)	overall	8.61	1.16	5.03	11.01	N = 1943
	between		1.13	6.29	10.75	n = 129
	within		0.16	7.35	9.64	T-bar = 15.06

Table 9: Summary statistics for Panel data

Variable	Description and Sources
QOG	ICRG indicator of Quality of Government obtained as the mean value of the ICRG variables "Corruption", "Law and Order" and "Bureaucracy Quality", scaled 0-1. Higher values indicate higher quality of government. Downloaded from www.qog.pol.gu.se (the name of the variable in the QOG dataset is QOG)
DEMOC	Index of democracy obtained as an average of the Polity and Freedom House indexes of democracy. Downloaded from www.qog.pol.gu.se (the name of the variable in the QOG dataset is fh polity2)
EDUC	Average numbers of years of education. Source: Barro and Lee (2010)
EDUC1	Index of Knowledge Distribution (Vanhanen 2003a; 2003b). Downloaded from www.qog.pol.gu.se (the name of the variable in the QOG dataset is van knowdist)
OPEN	Trade openness (source: Penn World tables)
ln(GDP PC)	Log GDP real per capita in PPP (source: Penn World Tables)
ELF	Ethnic Fractionalization from Fearon (2003). Downloaded from www.qog.pol.gu.se (the name of the variable in the QOG dataset is fe etfra)
COMMON LAW	Dummy variable that takes a value of one for countries with a common law legal origin. Source La Porta et al. (1998)
FRENCH LAW	Dummy variable that takes a value of one for countries with a French legal origin. Source La Porta et al. (1998)
GERMAN LAW	Dummy variable that takes a value of one for countries with a German legal origin. Source La Porta et al. (1998)
SCAND. LAW	Dummy variable that takes a value of one for countries with a Scandinavian legal origin. Source La Porta et al. (1998)
SOC. LAW	Dummy variable that takes a value of one for countries with a socialist legal origin. Source La Porta et al. (1998)
CATHOLIC	Share of Catholics in the population. Source La Porta et al. (1998)
PROTESTANT	Share of Protestant in the population. Source La Porta et al. (1998)
MUSLIM	Share of Muslim in the population. Source La Porta et al. (1998)
abs(Latitude)	Absolute value of the latitude of the capital city, divided by 90 (to take values between 0 and 1). Source: La Porta et al. (1998)
RSHOCK	Real external shock. Source: Jaimovich and Panizza (2006)

Table 10: **Definition of variables and sources**