

Is Democracy Property Rights Friendly?

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ABSTRACT

This paper examines 135 countries' democracy, business freedom, urbanization, and gross domestic product to determine its affect on property rights. The hypotheses focus on whether democracy and business freedom affects democracy.

The study uses an ordered logistic model to examine the relationship among factors to determine significance that contribute to the model. In addition, marginal effects and endogeneity tests are implemented due to the substance of the empirical justification and regression technique. Research indicates support for democracy, business freedom and gross domestic product. Cross-sectional and time series data are used to compare the variables from 1995-2005.

The results of this study indicate democracy and business freedom affect property rights. However, property rights do not affect democracy when an instrumental variable is created to address endogeneity. Future research is recommended to use other measures for urbanization and its impact on property rights. In addition, governments could secure freedom in order for its citizens to sustain property rights.

Introduction

Democratic nations are considered to provide their citizens with opportunities for advancement within their societies, and the ability to openly voice their own opinions. People may feel more secure to invest in democracies than non-democracies because of the assumption it will enforce rights. Citizens may also be more willing to open businesses in their respective countries only if their property is secured by the government. Citizens that lack confidence in their governmental structures may choose to retain their savings through personal measures such as saving funds within the household, which could hinder economic development.

Therefore, I propose does democracy affect property rights? The assumption is that democracy is able to guarantee the aforementioned rights. However, a standard definition for democracy is nonexistent since it is interpreted in various ways by different people. Marshall and Jagers suggests democracy as an institution, which citizens can impose preferences and limit powers on its leaders (Marshall and Jagers 2006, 17). Kane and Beach note, “Secure property rights give citizens the confidence to undertake commercial activities, save their income, and make long-term plans because they know their income and savings are safe from expropriation” (Kane and Beach 2008, 13).

The purpose of this paper is to demonstrate an empirical analysis between democracy and property rights by including the role of business freedom to determine if democracy upholds its purpose. Caporaso and Levine point out, “Legislation can create or eliminate property rights,” which affects citizens’ rights (Caporaso and Levine 1992, 89).

The importance of this research is it conflicts with illiberal democracy. Critics of democracy have suggested some countries with a democratic framework are faulting on delivering rights to its citizens, which results in illiberal democracy. Leaders are elected into

power, but they are not really representing the interests of its people. Zakaria notes, “Democratically elected regimes often ones that have been reelected or reaffirmed through referenda, are routinely ignoring constitutional limits on their power and depriving their citizens of basic rights and freedoms” (Zakaria 1997).

I propose factors such as institutional democracy and business freedom will have an affect on property rights. Democracy is a necessary element to guarantee rights and to give citizens the ability to elevate their social status by engaging in investment opportunities.

Theory

The negative view of populism is that leaders’ actions are based on their self-interest, which alienates democracy. Populist leaders initially implement policies, to make themselves favorably and appeal to lower class citizens (Tsafos 2007). However, critics suggest populism has a negative influence on business¹. Populism creates more restrictions and increases the cost of business (Tsafos 2007, 102). For instance, a populist leader may impose guidelines on businesses that require additional taxes. This leads to businesses to decrease their investments. Tsafos notes, “A country which alienates investors will soon find that it makes less money from its natural wealth” (Ibid 2007, 155).

Democracy is also embedded in the foundation of liberalism. Liberalism provides individuals assurance on freedom to pursue their rights. For instance, the protection of basic rights such as law and property are entities of liberty (Zakaria 1997). Liberalism guarantees rights. Bittick notes, “Liberal states practice and promote individual rights abroad, and this becomes a standard by which to differentiate nations in the international realm” (Bittick 2007, 6). Government supplies individuals with democracy, which expands their opportunities to gain wealth (Ringen 2007).

¹ Articles on Populism focus on Latin America. This study also includes Latin American countries.

Literature Review

In order for a country to be prosperous an enforcement of contracts is necessary for a secured investment. Wright points out, “Contractual obligation, private property rights, and the justice system cannot function in a society without a commonly held notion of what a contract actually is, what can and cannot be legitimately be bought and sold and what constitutes fairness” (Wright 1997, 39). It is suggested that a democratic government would guarantee rights of citizens; therefore, making citizens more apt to conduct economic transactions. Knack and Keefer contend if citizens feel that their property rights are not valued they would not invest (Knack and Keefer 1995, 209).

Feng notes, “A democratic system induces and enhances investment primarily through the protection of property rights, demonstrating the fundamental link between political institutions and private investment” (Feng 2003, 160). Investors are more apt to be confident and invest in a democracy since it reduces uncertainty of their investment (Ibid 2003, 161).

Leblang focuses his research on democracy, property rights and economic growth. In order for economic growth to occur in countries democracies must provide property rights (Leblang 1996). He uses Freedom House data in order to measure property rights and includes government market regulations such as foreign exchange controls and total credit allocated to private industries. Leblang suggests foreign exchange controls decreases property rights by diverting investments since it imposes additional administrative fees. On the other hand, total credit alleviates private industries since financial institutions are aiding their endeavors (Leblang 1996, 12). The results indicate democratic countries protect property rights than non-democratic countries (Leblang 1996).

Alesina suggests countries claim democracy²; however, their markets are highly protected by elites. This makes it difficult for individuals to open their own businesses due to the increased length of time and of governments being influenced by insiders (Alesina 2006). This delay in business freedom could create a lack of trust in property rights.

Urbanization of societies is influenced by its respective countries' economics. Wealthy countries tend to be more democratic and could offer an advantage for its citizens the ability of closer urban networks. Rudra notes, "Higher urbanization makes it increasingly difficult for those in power to prevent democratization" (Rudra 2005, 713). Urbanization could cause an influx of property rights since individuals may pursue business opportunities due to its network.

There is vast literature on democracy and economic development; however, in order for a country to achieve economic development there must be a guarantee of property rights. Olson notes, "No society can work satisfactorily if it does not have a peaceful order" (Olson 1993, 567). Overall Leblang's empirical study on democracy, property rights and economic development is the closest study to this research³. However, I reject Leblang's government market regulations measures such as foreign exchange controls and total credit. Thus, I propose an improved measure is business freedom, which allows businesses to open, operate and close provided by government protection (Heritage Foundation 2008). I suggest this is an efficient measure to capture government market regulation.

Research Design

In order to conduct the research, secondary data is obtained from Freedom House, World Bank and the Heritage Foundation. Data gathered is transferred into STATA statistical software

² Alesina focuses on countries within the European Union and compares its markets to the U.S.

³ This is from my research.

for the analysis. This research examines 135 countries from 1995-2005⁴, and an ordered logit regression analysis is used to examine the relationship between democracy and property rights⁵. Therefore, I hypothesize institutional democracy affects property rights. I also hypothesize business freedom has an affect on property rights.

The Data

Key Variables

- *Property Rights*: The ability for individuals to own private property that is acknowledged by its respective country. In addition, the measure examines if the judiciary is able to enforce property rights (Heritage Foundation 2008). The scale is from 10-90, which 10 represent the least amount of property rights and 90 represents a high amount of property rights. This measure is derived from the Heritage Foundation⁶.
- *Democracy*⁷: Institutional democracy is used as a measure, which is derived from Gurr's Polity IV dataset. Institutional democracy is composed of three measures if citizens are able to have an influence on policies, the ability of constraints on leadership and the guarantee of civil liberties and political participation (Marshall and Jaggers 2006, 17). This measure is used since it captures the policy interests of citizens on its elected officials. This could have an impact on property rights. The scale for institutional democracy ranges from 0-10. The higher the number represents a democratic country. I expect the relationship between democracy and property rights to be positive and statistically significant.

⁴ Timeframe is chosen since Leblang's research ends in 1996. In addition, Heritage Foundation began collecting its data on economic freedom in 1995.

⁵ Due to the categorical scale of property rights, ordered logit is the best method for analysis since measures are in categories ranging from 10-90.

⁶ Heritage Foundation classifies the scores as 80-100 free, 70-79.9 mostly free, 60-69.9 moderately free, 50-59.9 mostly unfree and 0-49.9 repressed (Heritage Foundation 2008).

⁷ The democracy and polity terms are exchanged frequently in this paper.

- *Business Freedom*: Individuals that are interested in doing business are more able to succeed in this effort by the availability and ease of pursuing licenses and permits. The measurement scale is from 10-90, which the higher number represents free and the lower the number is not free. The operation of business is able to succeed with influence of government regulations. This measure is derived from the Heritage Foundation. I expect the relationship between business freedom and property rights to be positive and statistically significant.

Additional Variables

There are control variables included in this study, which is gross domestic product and urbanization.

Control Variables

- *Urbanization*: An urbanized society would have more employment opportunities, which is influenced by their education. Property rights would be a significant factor for an urban society to invest. I expect the relationship between urbanization and property rights to be positive and statistically significant.
- *Gross Domestic Product*⁸: Gross domestic product measures the size of a country's economy. Gross domestic product information is captured by U.S. millions of dollars and is available from the World Bank. I expect gross domestic product and property rights to be positive and significant.

⁸ In order to conduct the analysis a log of gross domestic product was created.

Empirical Analysis

Model Specification

In order to test for the hypotheses a multi-variate regression will be implemented. The model is displayed as follow:

$$\text{Property Rights} = b_0 + \text{Polity}b_1 + \text{Business Freedom} b_2 + \text{Urbanization}b_3 + \text{GDP} b_4 + e$$

Logistic Regression Results

Results of the Logistic Regression are displayed in Table 2. Due to the nature of a logit model, heteroskedasticity is already built into the model. Therefore, a robust standard errors logit regression was implemented. Outcome of the chi-square yielded a significant result LR chi2(4) = 758.99, $p > .01$. The probability of chi2 is significant at the .01 level since chi2=0.000, which is less than .01. The overall model is significant.

All of the independent variables yield significant p values less than .01, and are positive coefficients except for urbanization. Urbanization has a negative coefficient of -.031058, which displays higher levels of urbanization does not have an affect on property rights. The Pseudo R2 is 0.3640, which is 36% of variance accounted for the model. This leaves 64% accounted by other factors⁹.

See Tables 1, 2, 3

Marginal Effects

In order for better interpretation of the coefficients marginal effects is implemented for the data. Polity marginal effects are -.0165458. For every one unit the polity variable increases, the probability of property rates being 1 decrease by .016 units. The aforementioned scores represent a probability score of 30 on property rights. In addition, the business freedom marginal effect is -.0162044. Business freedom is not going to have an affect on property rights.

⁹ In addition, a correlation matrix was implemented on the variables and there is no multicollinearity (See Table 3). Summary Statistics are in Table 2.

Therefore, minimal levels of business freedom and democracy are not going to have an impact on property rights.

An increase of the probability of property rights at 90 displays different results. The polity marginal effects are .0046516. For every one unit, the polity variable increases, the probability of property rights being 1 increases by .004 units. In addition, the business freedom marginal effect is .0045556. For every one unit, the business freedom variable increases, the probability of property rights being 1 increase by .004. Therefore democracy and business freedom are positive contributors to property rights when the probability of property rights increases for countries.¹⁰

See Tables 4 and 5

Endogeneity

According to Locke, individuals have the right to property since it's their expected right influenced by religion. Younkins points out, "Locke's main theme was that the ownership of private property is a natural right of every individual and that this right predated by government" (Ibid 2002, 52). However property is not protected, which causes citizens to create a society to protect their rights (Locke 1960, 104). Property rights could cause democracy¹¹. Manent notes, "The purpose of the political institution is to preserve property endangered by the inevitable disorders of the state of nature" (Manent 1994, 48).

Business freedom could also be derived from property rights since established rights could induce individuals to pursue investments. The rule of law, which enforces property rights,

¹⁰ However, the explanatory variable coefficients are low.

¹¹ The property rights and democracy argument of which came first, continues to be a political discussion among scholars today. However, research is more focused on economic development. Property rights are essential for economic freedom. Scholars such as Feng (2003), Haan and Strum (2002) examine the relationship between political freedom and economic freedom or democracy and economic freedom.

can provide security for individuals interested in conducting financial transactions. People would be more inclined to pursue business initiatives as long as property rights are secured.

Gross domestic product could also be endogenous to property rights. Property rights could cause individuals to acquire additional funds through their investments. For instance, property such as real estate could accumulate in wealth over time creating more funds to its investors.

In order to address Endogeneity an instrumental variable was created among variables gross domestic product, business freedom and democracy¹². Since it is assumed there is possible joint causality in the empirical specification. The instrumental variable of gross domestic product has a negative coefficient and is statistically insignificant. The p value is at 0.721, which is greater than .05. Endogeneity between gross domestic product and property rights is irrelevant.

The instrumental variable for business freedom has a negative coefficient and is statistically significant. The p value is at 0.023, which is less than .10. Endogeneity between business freedom and property rights is existent. Property rights cause business freedom and business freedom affects property rights¹³.

Lastly an instrumental variable for democracy is created, which displays a positive coefficient and is statistically insignificant. The p value is at 0.191, which is greater than .05. Therefore there is no endogenous relationship between democracy and property rights.

See Tables 6, 7 and 8

¹² An instrumental variable is a new variable that's highly correlated to the independent variable causing the Endogeneity, but not correlated to the error of the independent variable.

¹³ Additional Endogeneity tests among business freedom and democracy is for future research.

Conclusion and Implications

On both hypotheses, we reject the null hypothesis and find support for the research hypotheses that business freedom and democracy affect property rights. However property rights are not endogenous to democracy. The concept of property rights could be a natural right such as Locke has claimed in the past. Scholars such as Olson suggest autocratic rulers would provide public goods to its citizens since it is important to his interests. In addition, Clague et al. contend autocracies provide rights to its citizens in order to extract taxes for the leaders' benefit (Clague et al. 1996). On the other hand, it is also suggested that a democratic government would guarantee rights of citizens; therefore, making citizens more apt to conduct economic transactions (Olson 1993, 569). Property rights are evitable in both governmental structures, yet property rights do not affect democracy.

An implication is for governments to secure freedom. Guaranteeing civil liberties such as property rights are necessary for societies to flourish and for individuals to conduct investments to enable their financial opportunities. Ringen points out, "Freedom without adequate protection in the institutions of the regime is transitory and unsafe" (Ringen 2007, 31). If autocracies and democracies fail on this notion, citizens may not feel confident in pursuing property rights. This could impede economic development for countries.

For future research other control measures could be used, which substitutes for urbanization since urbanization has a negative impact on property rights. It is initially assumed individuals that are mobilized influence democracy, which could correspond to an urbanized demographic (Rudra 2005). However, citizens may not be able to organize successfully in order to influence elected officials on property rights. Knack notes, "The influence of a group depends not only on the economic gain or loss that a group might incur from government action, but also

on the size of the group's membership and its organizational ability" (Knack 2003, 4). This notion provides substance to Olson's argument on collective action. He suggests large groups are unable to reap collective goods since smaller groups have an advantage of having their interests represented (Olson 1971, 18). Smaller groups have better access to elected officials in order to formulate policies.

In conclusion democracy affects property rights, but property rights do not affect democracy. In order for investment to be secured confidently governments must be accountable and be able to enforce laws and regulations pertaining to property rights. Countries that are able to succeed generate additional wealth and trust from investors, and investors are able to continue on making on investments to generate personal wealth and economic development.

Table 1. Ordered Logistic Regression Robust Standard Errors-Property Rights

Variables	Coefficients	Standard Error	T-Statistic	P-Value
polity	.1477035	.0172479	8.56	0.000
bfree	.1446553	.0079342	18.23	0.000
loggdp	.8918574	.0855032	10.43	0.000
urban	-.031058	.0046345	-6.70	0.000
		Prob > chi2 = 0.0000	N=1225	Pseudo R2= .3640

Table 2. Summary Statistics

Variables	Obs	Mean	Std. Dev.	Min	Max
propright	1386	52.74892	23.69522	10	90
polity	1372	5.497085	3.946486	0	10
bfree	1386	64.54545	13.4087	40	100
loggdp	1415	7.643704	1.652153	4.39456	10.61145
urban	1463	55.45995	23.66796	7.3	100

Table 3. Correlation Matrix

Variables	Propright	Polity	Bfree	Urban	loggdp
propright	1.0000				
polity	0.4812	1.0000			
Bfree	0.7610	0.3206	1.0000		
Urban	0.4702	0.3446	0.5096	1.0000	
loggdp	0.6979	0.5087	0.6387	0.7939	1.0000

Table 4. Marginal Effects Summary

PropRight	Freq.	Percent	Cum.
10	63	5.14	5.14
30	332	27.10	32.24
50	374	30.53	62.78
60	9	0.73	63.51
70	228	18.61	82.12
90	219	17.88	100.00
Total	1225	100.00	

Table 5. Probability Marginal Effects

Variables	Coefficients	Standard Error	T-Statistic	P-Value
Pr(10)				
polity	-.0007725	.0001423	-5.43	0.000
bfree	-.0007565	.0001134	-6.67	0.000
loggdp	-.0046644	.000805	-5.79	0.000
urban	.0001624	.0000337	4.82	0.000
Pr(30)				
polity	-.0165458	.0022736	-7.28	0.000
bfree	-.0162044	.0013376	-12.11	0.000
loggdp	-.0999063	.010636	-9.39	0.000
urban	.0034791	.000541	6.43	0.000
Pr(50)				
polity	-.0099389	.002114	-4.70	0.000
bfree	-.0097338	.0019383	-5.02	0.000
loggdp	-.0600129	.01295	-4.63	0.000
urban	.0020899	.0005022	4.16	0.000
Pr(60)				
polity	.0011702	.0004503	2.60	0.009
bfree	.001146	.0003815	3.00	0.003
loggdp	.0070656	.0025317	2.79	0.005
urban	-.0002461	.0000961	-2.56	0.010
Pr(70)				
polity	.0214354	.0026044	8.23	0.000
bfree	.0209931	.0016812	12.49	0.000
loggdp	.1294307	.014019	9.23	0.000
urban	-.0045073	.0007001	-6.44	0.000
Pr(90)				
polity	.0046516	.000676	6.88	0.000
bfree	.0045556	.000503	9.06	0.000
loggdp	.0280872	.0034767	8.08	0.000
urban	-.0009781	.0001511	-6.47	0.000

Table 6. Endogeneity Instrumental variable gross domestic product

Variables	Coefficients	Standard Error	T-Statistic	P-Value
polity	.1351043	.1835177	0.74	0.462
bfree	.6121284	.0463701	13.20	0.000
loggdp	9.589708	1.040683	9.21	0.000
urban	-.3528824	.0672601	-5.25	0.000
iv_loggdp_~s	-.5911363	1.653314	-0.36	0.721
cons	-42.26445	5.452097	-7.75	0.000
		Prob > chi2 = 0.0000	N=1141	R2= .6669

Table 7. Endogeneity Instrumental variable business freedom

Variables	Coefficients	Standard Error	T-Statistic	P-Value
bfree	.6788248	.0502542	13.51	0.000
polity	.2262269	.188238	1.20	0.229
urban	-.3658142	.0668158	-5.47	0.000
loggdp	9.407555	1.035273	9.09	0.000
iv_bfree_~s	-.1659146	.0731324	-2.27	0.023
cons	-44.9905	5.465205	-8.23	0.000
		Prob > chi2 = 0.0000	N=1105	R2= .6749

Table 8. Endogeneity Instrumental variable Polity

Variables	Coefficients	Standard Error	T-Statistic	P-Value
bfree	.6092447	.0464404	13.12	0.000
polity	.0613143	.1929303	0.32	0.751
urban	-.3446147	.0677083	-5.09	0.000
loggdp	9.611191	1.043237	9.21	0.000
iv_polity_~s	.4861345	.3166259	1.54	0.125
cons	-42.22144	5.458614	-7.73	0.000
		Prob > chi2 = 0.0000	N=1135	R2= .6666

Appendix A. List of Countries

Countryname	Code	Countryname	Code	Countryname	Code
USA	111	Paraguay	288	Vietnam	582
UK	112	Peru	293	Algeria	612
Austria	122	Uruguay	298	Angola	614
Belgium	124	Venezuela	299	Botswana	616
Denmark	128	French Guinea	333	Burundi	618
France	132	Guyana	336	Cameroon	622
Germany	134	Belize	339	Chad	628
Italy	136	Jamaica	343	Congo, Rep	634
Netherland	138	Suriname	366	Congo, DemR	636
Norway	142	Trinidad&T	369	Ethiopia	644
Sweden	144	Bahrain	419	Gabon	646
Switzerland	146	Cyprus	423	Gambia	648
Canada	156	Iran	429	Ghana	652
Japan	158	Iraq	433	Cote D Ivoire	662
Finland	172	Israel	436	Kenya	664
Greece	174	Kuwait	443	Lesotho	666
Ireland	178	Lebanon	446	Libra	672
Malta	181	Oman	449	Madagascar	674
Portugal	182	Qatar	453	Malawi	676
Spain	184	Saudi Arabia	456	Mali	678
Turkey	186	Yemen	459	Mauritania	682
Australia	193	Syria	463	Mauritius	684
New Zealand	196	U.A.E.	466	Morocco	686
South Africa	199	Egypt	469	Mozambique	688
Argentina	213	Bangladesh	513	Niger	692
Bolivia	218	Cambodia	522	Nigeria	694
Brazil	223	Sri Lanka	524	Zimbabwe	698
Chile	228	Taiwan	528	Rwanda	714
Colombia	233	China	532	Senegal	722
Costa Rica	238	India	534	Sierra Leone	724
Dom. Republic	243	Indonesia	536	Somalia	726
Ecuador	248	Korea	542	Namibia	728
El Salvador	253	Laos	544	Sudan	732
Guatemala	258	Malaysia	548	Swaziland	734
Haiti	263	Nepal	558	Tanzania	738
Honduras	268	Pakistan	564	Uganda	746
Mexico	273	Philippines	566	Burkina Faso	748
Nicaragua	273	Singapore	576	Armenia	911
Panama	283	Thailand	578	Azerbaijan	912

Countryname	Code
Albania	914
Georgia	915
Kazakhstan	916
Kyrgyz Rep	917
Bulgaria	918
Moldova	921
Russia	922
Ukraine	926
Uzbekistan	927
Cuba	928
Czech Rep	935
Hungary	944
Croatia	960
Macedonia,fyr	962
Poland	964
Romania	968

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