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FROM GOVERNANCE TO GROWTH: INSTITUTIONAL AND MARKET DRIVERS OF GDP PER CAPITA IN ROMANIA (1998–2023)

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Abstract

This study analyses the relationship between the quality of public administration and economic growth in Romania, between 1998 and 2023. The question it seeks to answer is whether state institutions in Romania have reformed under internal or external pressures?

The indicator used to measure economic performance is GDP per capita correlated with other indicators that measure real convergence such as governance, quality human development, financial market development, foreign direct investment and fiscal capacity. To capture the structural changes, the period under review is divided into four subintervals, reflecting structural and economic changes and external pressures: 1998-2006 (pre-EU accession period), 2007-2015 (global financial crisis), 2015-2019 (recovery period) and 2020-2023 (COVID 19). The results confirm that public institutions in Romania improved when only there were external pressures to make administrative reforms: required to join EU (1998-2006), required by International Monetary Fund (2007-2015), required to access EU pandemic recovery funds (2020-2023). In the absence of these pressures, the quality of institutions decreased (2015-2019). These results confirm the Public Choice theory and crisis triggered reform (Rodrik, 2007), reflecting the importance of conditionality and external anchoring in governance transformation.

Keywords: institutional reform; public administration; external conditionality; governance indicators; Romania.

JEL Classification: H83; D7; L1; Z18.

1. INTRODUCTION

In the recent decades, Romania has undergone major economic and administrative transformations, but their pace and depth have varied. The quality of its institutions has had periods of accelerated reforms, but also periods of stagnation or regression. This study attempts to find out the causes of these changes. There were internal changes generated by the political environment attentive to the needs of society or they have been generated externally by crises (financial, medical) and requirements of some institutions (EU, IMF)?

Figure 1 shows that the Romanian government becomes more efficient only under external pressure. This occurs during the start of EU accession negotiations in 2000, the EU warning in 2004 that Romania risked missing the

2007 accession because of slow reforms, the completion of the final accession reforms in 2006, the signing of the financing agreement with the International Monetary Fund between 2009 and June 2013, and the signing of the NRRP agreement with the EU in November 2021. Once these pressure points pass, government efficiency declines.

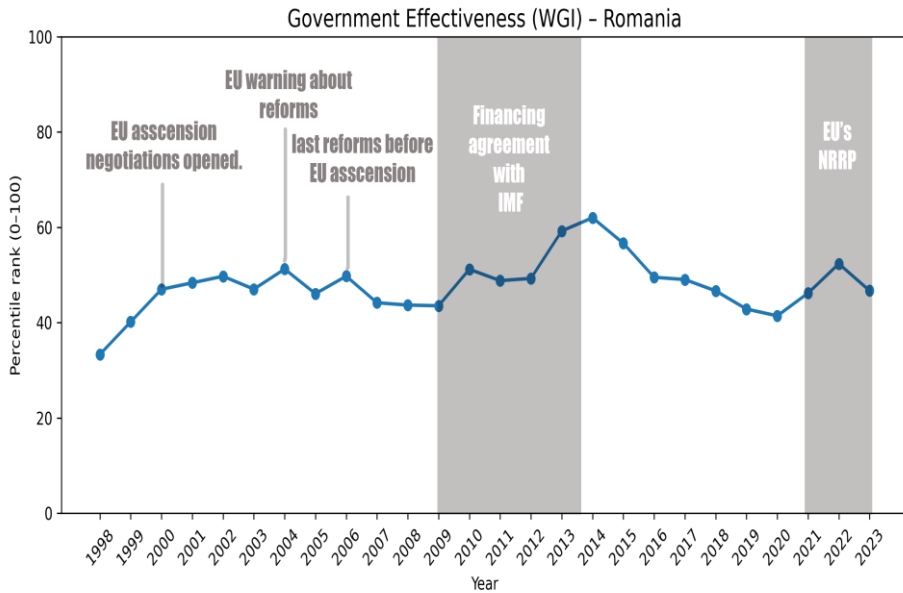


Figure 1. Government Effectiveness in Romania

Source: World Bank (2026)

The quality of public administration is an important component of a country's economic growth. Although economic performance has had a positive trajectory for most of the period, the quality of institutions has not always followed the same path. Governance, administrative efficiency, political stability or the capacity to collect budget revenues are just a few of the indicators that have not evolved in a linear manner, and sometimes have reacted countercyclically to economic performance.

We will be able to observe how Romanian institutions acted in four key moments in Romania's recent history: EU pre-accession, the financial crisis, the recovery from the financial crisis and the COVID-19 pandemic and to what institutional improvements coincided with external pressures.

This study aims not only to describe, but also to provide a coherent explanatory framework, integrating relevant theoretical contributions from the field of institutional economics and public choice theory.

2. METHODOLOGY

This study has a quantitative approach and uses globally recognized data divided into four distinct stages, corresponding to different macroeconomic and political contexts: the pre-accession period to the European Union (1998-2006), European Union accession and the global financial crisis (2007-2014), the post-crisis economic recovery (2015-2019), and the health and economic crisis caused by the COVID-19 pandemic (2020-2023).

For each of these periods, annual data were collected on the following indicators.

Table 1. Indicators used

Indicator	Definition	Data Source
GDP_PC	GDP per capita (current USD)	World Bank (2025)
GCF_GDP	Gross Capital Formation (% of GDP)	World Bank – WGI (2025)
WGI_Gov_Effectiveness	Government Effectiveness (Worldwide Governance Indicator)	World Bank – WGI (2025)
WGI_Reg_Quality	Regulatory Quality (Worldwide Governance Indicator)	World Bank – WGI (2025)
WGI_Rule_of_Law	Rule of Law (Worldwide Governance Indicator)	World Bank – WGI (2025)
WGI_Control_Corruption	Control of Corruption (Worldwide Governance Indicator)	World Bank – WGI (2025)
WGI_Political_Stability	Political Stability and Absence of Violence (Worldwide Governance Indicator)	World Bank – WGI (2025)
PPP	GDP per capita, purchasing power parity (current international USD)	World Bank (2025)
WGI_Voice_Accountability	Voice and Accountability (Worldwide Governance Indicator)	World Bank – WGI (2025)
HDI	Human Development Index	UNDP (2025)
Stock_Exchange	Bucharest Stock Exchange, BET index, end of year values	BVB.ro
FDI_GDP	Foreign direct investment, net inflows (% of GDP)	World Bank (2025)
Tax_Revenue_GDP	Tax revenue (% of GDP)	World Bank (2025)
Debt_GDP	General government gross debt (% of GDP)	Eurostat (2025)
Unemployment	Unemployment rate (% of total labor force)	World Bank (2025)

Source: computed by the author

The analysis is based on two types of measurements, for each period:

- Pearson correlation (calculated with ChatGPT) between GDP per capita and the rest of the indicators, to check if they have evolved in tandem with economic growth;
- average rate of change of each indicator, expressed in percentages (%), percentage points (pp) or points (for WGI indicators).

This combination of correlations and trends allows us to identify not only the direction of the relationship between institutions and economic performance, but also its intensity. Comparative analysis between periods clarifies whether reforms were continuous or dependent on external factors.

3. RESULTS

3.1. Before EU Accession (1998-2006)

For Romania, the period 1998-2008 was one of intense reforms that led to accelerated economic convergence. The state liberalized the markets, carried out privatizations and adopted institutional reforms imposed by the preparation for EU accession. Romania had a GDP_PC increase by 15.23%, possible primarily because it had a low starting point. In 1998 GDP_PC was 1852.55 USD and in 2006 it reached 5757.53 USD, in almost perfect correlation with the dynamics of the stock market (0.994) and GCF_GDP (0.940), this indicates a classic phase of economic convergence according to the Income Convergence theory (Barro, Sala-i-Martin, 1991, 1995), which claims that poorer economies tend to grow faster than developed ones when they adopt appropriate policies and integrate modern technology.

Table 2. Correlations with GDP per capita 1998-2006 (descending order)

Indicator	Correlation with GDP_PC	Avg annual change (%)
GDP_PC	1.000	15.23 %/yr
Stock Exchange	0.994	46.58 %/yr
GCF_GDP	0.940	3.69%/yr
PPP	0.978	9.62 %/yr
HDI	0.919	1.25 %/yr
WGI Control of Corruption	0.896	2.01 points/yr
FDI (% of GDP)	0.824	0.52 pp/yr
WGI Regulatory Quality	0.729	0.55 points/yr
WGI Rule of Law	0.711	0.34 points/yr
WGI Government Effectiveness	0.401	2.05 points/yr
Tax revenue (% of GDP)	0.390	0.03 pp/yr
WGI Political Stability	0.282	0.11 points/yr
WGI Voice and Accountability	0.177	0.29 points/yr
Unemployment	-0.374	-0.30 pp/yr
Debt to GDP	-0.984	-1.65 pp/yr

Source: computed by the author

FDI (0.820 | 0.52 pp/yr) and GCF_GDP (0.940 | 3.69%/yr) shows that growth was strongly investment led. But these FDIs were possible because Romania has become a more trustworthy country, after strengthening its institutions, as reflected in the strong correlation with Control of Corruption (0.900), Rule of Law (0.710) & Regulatory Quality (0.730) (North, 1990).

Unemployment rate decreased from 9.6% in 1998 to 7.6% in 2006. FDI enters economic sectors where local firms are weak, creating new production capacity, which immediately means new jobs. Low labor costs can make the economy grow rapidly through trade integration (Low-cost integration into international markets (Krugman, 1991).

FDI (0.824) & Government Effectiveness (0.401) shows that the increase was possible due to private initiative and market liberalization (Păun, 2006).

The strong links between PPP (0.980) and HDI (0.920) shows that growth extended beyond GDP figures and the living standards improved, people's purchasing power increased, and broader well-being indicators followed suit, it validates Sen's claim that growth can be development when institutions allow translation into welfare. (Sen, 1981, 1999).

Political Stability (0.282), Control of corruption (0.900), Rule of law (0.710) and Regulatory quality (0.730). This suggests that growth does not require a calm political environment but it requires rules that work. As long as contracts are enforced and regulation does not choke activity, the economy can keep moving even when politics is noisy or unstable. Stability, by itself, seems less decisive than whether institutions are predictable and credible (Olson, 1982; Rodrik, 2000).

Financial markets often move ahead of the real economy, as investors react to expectations and signals before they appear in official statistics. For this reason, stock prices tend to behave as early indicators of economic cycles (Mitchell, 1927). On the Bucharest Stock Exchange, the very strong correlation with GDP_PC (0.994 | 46.58 %/yr) reflects this forward-looking behavior.

In nominal terms, public debt increased steadily, from USD 10.11 billion in 1998 to USD 54.98 billion in 2006. However, the debt-to-GDP ratio declined over the same period (-0.984 | -1.65 pp/yr), as economic growth exceeded the pace of public borrowing. This outcome is consistent with public debt sustainability theory, which stresses that debt trajectories are shaped primarily by the balance between growth and fiscal dynamics, not by the absolute level of debt itself (Blanchard, 1990; Barro, 1979).

3.2. After EU Accession & Economic crisis (2007-2014)

The period after EU accession and during the economic crisis (2007-2014) marks a shift for Romania, in which the momentum of rapid convergence is interrupted by a major external shock. GDP_PC drops from 15.23 %/yr to 2.64 %/yr and the drivers of growth change fundamentally. In 2019, Romania signed a financing agreement with the International Monetary Fund for 2009-2011. This

agreement was conditional on a series of structural reforms. A second preventive agreement was signed for 2011-2013, again conditional on structural reforms. As a result, Romania had better institutions WGI Regulatory Quality (0.53 points/yr), WGI Rule of Law (1.82 points/yr), WGI Government Effectiveness (2.55 points/yr).

Table 3. Correlations with GDP per capita 2007-2014 (descending order)

Indicator	Correlation with GDP_PC	Avg annual change (%)
GDP_PC	1.000	2.64 %/yr
PPP	0.486	6.02 %/yr
WGI Control of Corruption	0.463	0.07 points/yr
Tax revenue (% of GDP)	0.428	0.06 pp/yr
HDI	0.354	0.53 %/yr
WGI Government Effectiveness	0.332	2.55 points/yr
WGI Rule of Law	0.305	1.82 points/yr
WGI Voice and Accountability	0.246	-0.07 points/yr
Debt to GDP	0.180	4.09 pp/yr
FDI (% of GDP)	0.137	-0.55 pp/yr
GCF_GDP	-0.070	-4.13%/yr
WGI Regulatory Quality	-0.047	0.53 points/yr
WGI Political Stability	-0.372	-0.24 points/yr
Stock Exchange	-0.425	-4.57 %/yr
Unemployment	-0.516	0.07 pp/yr

Source: computed by the author

Among the measures requested by the IMF was the increase of the VAT rate from 19% to 24%, which is reflected in Tax revenue (% of GDP) (0.428 | 0.06 pp/yr). This timing implies a rise in fiscal pressure when private demand and income were already under pressure. Such a pattern is consistent with the theory of procyclical fiscal policy, which argues that in emerging economies fiscal policy often amplifies, rather than smooths the business cycle. Instead of providing countercyclical support during downturns, governments raise taxes or cut spending to address financing constraints, thereby deepening the contraction (Kaminsky et al., 2004).

The positive but moderate correlations between government effectiveness (0.332 | 2.55/yr) and rule of law (0.305 | 1.82 point/yr) with GDP_PC growth (2.60%/yr) are consistent with institutional economics, particularly the concept of institutional lag developed by Douglass North (1990). In this framework, institutions function primarily as stabilizing constraints that reduce uncertainty and support system resilience, rather than as immediate engines of economic growth, especially during periods of strong external shocks.

FDI (0.137 | -4.13%/yr), GCF_GDP (-0.070 | -4.13%/yr), Stock Exchange (-0.425 | -4.57 %/yr), indicates that investors withdrew capital and postponed new projects, A similar view is shared by Daniel Dăianu in *The Global Crisis and Romania's Vulnerabilities* (2009), where he portrays the crisis

as a moment of reckoning that revealed how dependent Romania's economic ascent had become on external capital inflows.

In the other 3 periods analyzed, Stock Exchange was strongly correlated with GDP_PC, in this period, although GDP_PC (2.64 %/yr) was positive, Stock Exchange (-0.425 | -4.57 %/yr) was negative, which is in line with the articles by Levine & Zervos (1998) and Demirgüç-Kunt & Maksimovic (1996) who say that the stock exchange correlates with the economy in the long run, but in crises, the correlation is reversed.

PPP (0.486 | +6.02%/yr) and HDI (0.354 | +0.53%/yr) indicate that income convergence continued after EU accession. The growth of purchasing power parity (PPP) was substantially faster than improvements in human development, suggesting that convergence toward EU income levels occurred primarily through price adjustments and nominal income effects, rather than through sustained productivity gains, because GDP per capita only grew by +2.64 %/yr, price-level convergence under economic integration (Balassa, 1964). Economies starting from lower income levels can catch up through integration and capital deepening without necessarily undergoing deep structural transformation (conditional convergence theory within neoclassical growth models (Solow, 1956; Barro, 1991).

3.3. Recovery (2015-2019)

The recovery period (2015-2019) marks a return to sustained economic growth in Romania after the post crisis adjustment, but with a different growth pattern driven mainly by domestic consumption, rising wages, and improved labor market conditions. The negative correlation between governance and GDP (2015–2019) suggests a shift toward consumption-led growth (fueled by tax cuts and wage hikes) which requires less institutional capacity than investment led growth. However, this creates a 'governance deficit' that leaves the economy vulnerable to future shocks.

Table 3. Correlations with GDP per capita 2015-2019 (descending order)

Indicator	Correlation with GDP_PC	Avg annual change (%)
GDP_PC	1.000	9.68 %/yr
GCF_GDP	0.980	2.55%/yr
PPP	0.973	11.67 %/yr
HDI	0.955	0.18 %/yr
Stock Exchange	0.734	9.25 %/yr
WGI Political Stability	0.247	2.35 points/yr
FDI (% of GDP)	0.184	0.12 pp/yr
WGI Voice and Accountability	0.079	0.18 points/yr
WGI Rule of Law	-0.101	0.60 points/yr
Debt to GDP	-0.843	-0.48 pp/yr
WGI Government	-0.884	-3.45 points/yr

Indicator	Correlation with GDP_PC	Avg annual change (%)
Effectiveness		
Unemployment	-0.891	-0.47 pp/yr
Tax revenue (% of GDP)	-0.937	-1.10 pp/yr
WGI Control of Corruption	-0.950	-1.19 points/yr
WGI Regulatory Quality	-0.978	-0.95 points/yr

Source: computed by the author

During EU accession (1998-2006) and the post-accession crisis period (2007-2014), institutional indicators such as regulatory quality, government effectiveness, and rule of law were positively correlated with GDP per capita and their efficiency was increasing. EU conditionality and crisis-related constraints limited policy discretion and forced improvements in administrative capacity and enforcement. In contrast, during 2015-2028, once Romania had reached a higher income level and external pressure weakened, the same institutional indicators deteriorated, WGI Government Effectiveness (-3.45 points/yr), WGI Control of Corruption (-1.19 points/yr), WGI Regulatory Quality (-0.95 points/yr), while GDP per capita continued to rise (9.68 %/yr). In the absence of binding external constraints, institutional efficiency was no longer actively enforced. Economic growth relied on market dynamics, domestic demand, and convergence effects rather than on further institutional strengthening (North, 1990; Rodrik, 2007).

GDP per capita grew by 9.68%/yr, having a near perfect correlation with PPP (0.973) and HDI (0.955), indicating that income, prices, and living standards advanced in tandem. Poorer economies grow faster than richer ones until convergence forces gradually weaken (Robert Barro and Xavier Sala-i-Martin, 1991 and 1995).

FDI (0.184 | 4.79%) is no longer a primary driver of growth, as the maturation of financial markets shifts the growth process toward domestic capital allocation and deepening. In this stage, internally generated savings and financial intermediation play a larger role than external capital inflows. This interpretation is consistent with domestic capital deepening theory (Schumpeter, 1911; Levine, 1997).

During the recovery period (2015-2019), GCF_GDP shows a very strong correlation with GDP_PC (0.980 | 2.55%/yr), indicating a clear re-coupling between investment and growth. However, the relatively modest pace of investment growth suggests a cyclical rebound rather than a structural investment shift.

Stock Exchange (0.734 | 9.25%/yr) increased in tandem with GDP per capita, indicating that equity prices increasingly reflected real economic fundamentals, such as income growth and improved expectations, rather than speculative or purely cyclical dynamics. This pattern is consistent with the semi-strong form of the Efficient Market Hypothesis, (Fama, 1970), which posits that publicly available information is rapidly incorporated into asset prices.

WGI Regulatory Quality (-0.978 | -1.39%/yr) declined as economic activity expanded faster than the regulatory system could adapt, generating increasing frictions between firms and the state. This pattern is consistent with institutional lag theory (North, 1990), which argues that institutions adjust more slowly than economic structures. It also supports the diminishing returns to institutions hypothesis (Rodrik, 2007), according to which institutional expansion yields high returns in early development stages but may reduce efficiency once an economy surpasses a certain income and complexity threshold.

Unemployment (-0.891 | -7.87%), strong growth reduces unemployment (Okun, 1962).

Tax revenue (% of GDP) (-0.937 | -1.10 pp/yr) declined, a key driver was the reduction of the VAT rate from 24% to 20% in 2016 and further to 19% in 2017, to support consumption and domestic demand. It aligns with the logic of the Laffer curve (Laffer, 2004), which argues that beyond a certain point, lower tax rates can sustain economic activity even as tax revenues fall relative to GDP.

3.4. Pandemic (2020-2023)

The pandemic hit Romania's economy hard in 2020, but EU stepped in to help Romania, allocating funds through the PNRR. These funds were conditional on implementing administrative reforms. Unlike the 2007 economic crisis, this time the state acted countercyclically. In addition to EU funds, Romania borrowed to stabilize the economy, public debt to GDP increased from 43.25% in 2019 to 57.14% in 2020 then declined to 50.88% in 2022, confirming that the role of the state is to intervene when the private sector is affected (Keynes, 1936).

Table 4. Correlations with GDP per capita 2020-2023 (descending order)

Indicator	Correlation with GDP_PC	Avg annual change (%)
GDP_PC	1.000	12.05 %/yr
HDI	0.968	0.32 %/yr
Stock Exchange	0.961	16.17 %/yr
PPP	0.957	9.91 %/yr
Tax revenue (% of GDP)	0.908	+1.01 pp/yr
WGI Control of Corruption	0.810	+1.57 points/yr
WGI Rule of Law	0.695	+0.43 points/yr
WGI Government Effectiveness	0.451	+1.76 points/yr
WGI Regulatory Quality	0.313	+0.12 points/yr
FDI (% of GDP)	0.215	+0.35 pp/yr
Unemployment	-0.734	-0.17 pp/yr
Debt to GDP	-0.818	-3.13 pp/yr
WGI Political Stability	-0.826	-2.11 points/yr
WGI Voice and	-0.965	-1.15 points/yr

Indicator	Correlation with GDP_PC	Avg annual change (%)
Accountability		
GCF_GDP	-0.970	-2.48%/yr

Source: computed by the author

GCF_GDP (-0.970 | -2.48%/yr) shows the investments are cut and moderate increase of WGI Government Effectiveness (0.451 | 1.76 points/yr) suggests that state intervention during the crisis primarily fulfilled the stabilization role. Economic activity recovered without job losses, as reflected by a declining unemployment rate (-0.17 pp/year), while rising Stock Exchange (0.961 | 16.17 %/yr) indicate preserved confidence and anchored expectations.

The PPP (0.957 | 9.91%/yr) and HDI (0.968 | 0.32%/yr) continued to grow. These dynamics are consistent with Keynesian stabilization theory Keynes, 1936) and Musgrave's stabilization function of the state (Musgrave, 1959).

The strong negative correlation between GDP_PC (12.05 %/yr) and WGI Voice and Accountability (-0.965 | -1.15 points/yr) and Political Stability (-0.826 | -2.11points/yr) during the pandemic period is consistent with crisis governance theories (North) that emphasize a temporary tradeoff between democratic deliberation and rapid policy coordination.

As in the previous crisis in 2007, the pandemic period is associated with a decline in WGI Political Stability (-0.965 | -1.15 points/yr), This pattern is consistent with theories which argue that negative economic shocks increase social unrest, polarization, and pressure on political institutions. Economic downturns weaken political stability by intensifying distributional conflicts and reducing institutional legitimacy (Acemoglu and Robinson, 2006).

4. CONCLUSIONS

The central hypothesis guiding this study asked whether Romania's public institutions reform through endogenous dynamics or only under external pressure. The evidence across the four macroeconomic phases suggests then meaningful institutional reforms in Romania have predominantly been reactive, forced by external pressures rather than initiated autonomously from within.

The country underwent an intense period of reform which focused on meeting all EU requirements before its membership began. The UE interior space became the location where the group members walked at a reduced speed. The Romanian government responded slowly to the 2007 global financial crisis until external creditors including the IMF and EU established their conditions for action. The recession deepened because of the severe and procyclical measures which included the VAT increase. The economic growth returned but the institutions did not show any improvement in their operational effectiveness. The state decreased its governance indicators because it chose to use its resources for financial management instead of making organizational structure

changes. The pandemic brought various changes which impacted the original plan that existed before. The Romanian government took immediate action to handle this new external crisis by providing economic support through funding injections which followed a more opposite economic trend. The organization did not have any built-in motivation to change its operations. The process started because of two main factors which included both the need for immediate action and the availability of EU recovery funding.

Table 5. Institutional Responses and Reform Drivers in Romania (1998–2023)

Period	Institutional Action	Nature of Action	Primary Driver
1998–2006 (Pre-EU accession)	Broad administrative and legal reforms to align with EU standards	Proactive but externally induced	EU conditionality
2007–2014 (EU Accession & financial crisis)	Austerity, VAT hikes, wage cuts, limited institutional deepening	Reactive, procyclical	IMF/EU pressure
2015–2019 (Recovery)	Weak reform, rollback of fiscal discipline, tax cuts, rising wages	Passive, procyclical	Domestic political cycles
2020–2023 (Pandemic)	Rapid fiscal expansion, targeted governance improvements tied to EU funding	Reactive, countercyclical	Crisis response, EU pressure

Source: computed by the author

In conclusion, Romania's public institutions in 1998–2023 reformed more in response to Brussels, Washington or global crisis than to Bucharest's own initiative. The absence of external anchors makes it possible for reform initiatives to become stuck while policymakers select inappropriate solutions because their domestic political environment supports populist and brief-term solutions. The hypothesis is affirmed, endogenous dynamics alone have rarely been sufficient to drive reform in Romania, reform episodes tend to coincide with moments when political resistance is temporarily weakened by crisis or external constraint (Rodrik, 2007). The Public Choice framework shows that institutional changes will stop because decision-makers must deal with political and bureaucratic incentives which oppose any modifications that result in short-term costs.

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