



DEMOCRATIC GOVERNANCE AND INSTITUTIONS FOR GROWTH

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Welcome to the Center for International Private Enterprise Development Institute. I am Kim Bettcher. I'm the Knowledge Management Officer at the Center for International Private Enterprise. Professor Douglass North has described the institutions that are needed to raise productivity and encourage long-term economic growth, and these are institutions like property rights and the ability to enforce contracts. I'm going to talk to you about the political environment in which these institutions can develop and be sustained.

The evolution of institutions

Now, institutions develop over long periods of time. There's no single decision that will establish any particular institution. However, in a democracy, the likelihood that good economic institutions will evolve and be sustained is higher. And when I'm speaking of democracy, I'm referring in particular to structures like mechanisms for popular participation and policymaking and accountability, as well as free and fair elections, of course. Many people have had the idea that authoritarian governments are more able to establish good policies for economic growth and to enforce these policies. It's just a lot simpler in an authoritarian system to make policy without worrying about anybody whose opinion may differ.

Problems with the “enlightened despot” rationale

This could be considered the “enlightened despot” theory of governance. There are some problems with this theory, however. One of the most significant problems is: what do you do if you have an unenlightened despot, if you're not so lucky to have a wise or considerate despot? There are many authoritarian rulers who have their own personal interests at heart and really are not concerned about the economic well-being of the country as a whole.

Also, even though there are plenty of authoritarians who would like to have good economic performance to establish their own legitimacy through economic performance, they face certain constraints. Most of these rulers have their political power based on elements of personal rule. They've given out favors to certain groups. They've given out patronage. And in this kind of environment, it's very difficult to establish the kind of level playing field with consistent rules that markets require and fair access to participate in markets, instead of having certain politically connected elements that do well and no institutional basis to the economy.



Misconceptions about democracy and development

Also, consider that we now know that investment is not the only key to development. People once thought that development was the single important factor. We now know that the kind of investment one has is critical – and by that I mean there has to be productivity and innovation in investment. And, simply speaking, one doesn't get creativity and innovation in closed repressive environments. A related notion or myth that people have subscribed to is that countries have to choose between development and democracy. They see democracy as a luxury that only rich nations can afford and think that given the pressing needs to end poverty and get growth going, democracy is something that has to be postponed until later. Well, actually the historical record doesn't bear this out. The empirical evidence shows that authoritarian regimes do not have an advantage in growth over democracies. And in fact, democracy creates a supportive environment for the development of good economic policies in a variety of ways.

Synergies between democracy and the market economy

Why does this happen? Well first, there are some common elements between democratic systems and market economies. The first of these is obviously freedom. If there is freedom in the political sphere, there is going to be freedom in the economic sphere and vice versa. You can't constrain the ability to communicate, to share information, to associate, tend to take all kinds of activities in one sphere without having some kind of negative effect in the other. Also, there are institutional connections. If you look at the fact that both democracies and market economies are about competition, competition is a good thing in that it provides choices to people and it creates incentives for everybody to do better. Now, the key here is that you don't have anarchical, destructive competition in a democracy or market economy. You have a stable set of rules of the game. The rules are known to everybody; they're predictable. So the way the game is played is predictable, and the outcomes can vary, but it's competition within a fair set of rules. And finally, there are some core values that are common to both systems. Democracies and market economies share values such as transparency, responsibility, and everyone having a fair chance to participate in the system.

How can democracy facilitate good economic policies?

Let me tell you some specific ways in which democracies will create a supportive environment for good economic policy. The first is stability. One indicator of stability that Harvard Professor [Dani] Rodrik has discovered is that democracies have lower economic volatility, less volatile economic performance. This means that the environment is more predictable and, more importantly, you can avoid disasters – always a good thing. Now, stability is due to several things. One is that democracies have institutionalized rules for succession in leadership. So if a leader retires, becomes less popular, is going to change for any reason, in democracy it's known how the elections



occur and the game plays out; whereas in an authoritarian system, a leadership change can become a crisis.

Democracies are founded on rule of law, which means that the same rules apply to everyone. There is a consistency in the policy environment and in the enforcement of the rules. Rule of law is important, and particularly to the support, the definition, and enforcement of property rights. Democracies also have an advantage in legitimacy over authoritarian regimes and that's because all stakeholders have the opportunity to participate in the policy process, and so you're less likely to have elements that have polarizing attitudes or anti-system sentiments.

Other advantages of democracy

Now, stability is one advantage of democracy. Another advantage is the checks on authority. The checks inherent in the democratic system mean that there are limits to possible abuses of authority, governments must be accountable to tax payers, and the government faces the need to be responsive to popular needs and popular demands for good policy. Let me ask you now: do you think that a very wise technocrat could come up with the optimum economic policy for any particular country? Well, it doesn't matter how smart the policymaker might be. Everyone needs information to create policy. And a lot of the essential information for economic policy is at the micro level. The micro information is information about what's happening in the day-to-day business environment. What do businesses need to succeed? What are the kinds of barriers that they're coming up against? In a democracy there is the crucial advantage that private elements, businesses, and other interests who are affected by policy can participate themselves and give input into the policy process. Also, in a democracy, proposals are debated. Alternative solutions are raised and debated. So there is always the possibility that someone will come up with a better idea than the technocrat had, and people can test out the ideas and know on what basis the decisions are being made.

Feedback mechanisms in democratic policymaking

Feedback is another characteristic of democratic policymaking. Once a policy has been decided and implemented, then there is the opportunity to see what the results are from that policy, and the people who are affected by that policy can respond to that and again have another stage of input into the policy process. These different characteristics that I've mentioned such as input, responsiveness, and feedback, all add up to greater adaptability for democratic systems for handling global change, economic change. And moving forward, adaptability means that democracies do a better job of avoiding both very rigid economic policies and also very volatile policies.



The components of democracy

All right, I've talked about some of the advantages of democracy. Let me be clear about what are the components of a true full democracy – and I'm thinking in particular of democratic governance. Governance is about the decision-making that must occur in a democracy between elections, the policy process that we've been talking about. Now, the components of good governance are that the government must be effective, the government must be responsive and, not just focusing at the government, but there must be citizen participation in the policy process. By effective government I mean things like the quality of the public administration. Is it well trained? Does it have integrity? As well as the quality of the laws - are there good laws in place? Are excessive laws, costly laws eliminated? As far as a responsive and accountable government goes, it's essential to have rule of law, freedom of information, transparency, and participation is crucial.

The quality of representation in a democracy

Which brings me to my next topic, which is the quality of representation in a democracy and how that affects the economic policies. Some scholars have been very concerned that the various interest groups in a democracy will engage in rent seeking. That is to say that each group will seek narrow favors or privileges for itself, for its own constituents at the cost of the well-being of a society as a whole. That is, they're claiming benefits for themselves from government without creating new value through the policies or the resources that they're claiming. Now, certainly there are groups that will indeed seek to claim rents for themselves. The challenge is to find a policy or representational environment in which a diverse set of groups can participate in the process and have it not be a zero-sum game. Because indeed, if you can establish good institutions that are for growth and productivity, then the economy as a whole benefits and it's not as important about who is getting which share of the pie.

The role of associations

So what does a good system of representation look like in a democracy? Well there is no one correct system, but some of the key elements would be: first, freedom of association. There has to be great freedom for people to form and participate in the associations that they want and the associations that they find provide value to them and their needs. These associations should be representative, truly representative, that they speak honestly for the groups that they say to. They have the backing of the constituents. That means then that a group doesn't have to speak for everybody. It should speak for its own group, it's own constituents.

Also there should be inclusiveness in associations, and this can happen in different ways. It is partly a matter of all groups having a fair chance to make their case before government, before the public. It can happen through coalitions. And we find that often



when you have a broad coalition of different associations coming together, when they can find agreement on a common economic policy, what you often have is really the market-oriented policy that's going to favor growth. So coalition building is important in a free environment.

An environment of democratic openness and transparency

There need to be forums or channels for public-private dialogue to occur. And it's crucial that this dialogue occur in an open transparent manner. This way everyone knows that no side deals are being made. Everyone can contribute to the common dialogue and you avoid the threat of corruption, conflict of interest. And finally, to have good representation and good policymaking, you need to have high quality information. What are the facts on the economy? What are the likely consequences of proposed policies? Who's going to provide this information? Well, the private sector think tanks, economic associations. A lot of parties in the private sector are good sources of information. You can't rely only on government information.

The example of Botswana

Let me give you one example of how democracy can be supportive of good policy environment for strong economic growth. Now, every country has a complex story, but Botswana is a fascinating case of a democracy, since it was founded in the 1960s, that has seen sustained economic growth over four decades that has outpaced its neighbors. There is a consensus that this strong performance is due to good economic policies and in particular property rights. Botswana's democracy was favorable to this in that there were some checks on authority and a government that needed to be responsive to needs for good policy.

One particular aspect of Botswana's experience is the public-private dialogue that evolved since the 1980s initiated by the Botswana Confederation of Commerce, Industry & Manpower (BOCCIM) - the umbrella organization for the private sector - that reached out to the government in the 1980s. And together they evolved a dialogue over two decades which consists of national business conference held every two years in which political business leaders come together to discuss the issues, as well as a high level consultative council in which ministers and business officials again debate the policies. This hasn't always been a smooth process, but over the years it has been a very effective one. And the private sector has won important gains for better economic policies such as abolishing some of the controls on prices and foreign exchange, reduction in the taxes, and creation of an agency for privatization. So that's just one example of how democracy creates a supportive environment for the evolution of good economic institutions.

Thank you.



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