Democracy, Good Governance, and Economic Development

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Abstract

The institutional deficit that characterizes so many developing and transitional countries—weak and arbitrary governance, weak protection of civil liberties, and inadequate regulatory and legal framework to guarantee property rights, enforce contracts, and reduce the transaction costs—deprive these countries of needed productive investment and economic growth. Improving the quality of governance is essential for economic development. What types of policies and institutions have the most positive and measurable effects on improving governance? What kinds of institutional arrangements are associated with economic growth and poverty reduction? Research shows that democracy influences economic growth. Specifically, secure private property rights that give incentives to individuals to be productive, institutionalization of the rule of law, especially constraints against executives, and electoral mechanisms that give citizens the ability to evict the “rascals” are essential to promoting growth. Thus, an obvious corollary is that democratization and decentralization without simultaneous strengthening of property rights and the rule of law may not always lead to effective democratic governance.

How important is good governance for economic growth? Can economic growth be sustained without good governance? The answer is best captured in the oft-cited aphorism that good governance promotes growth and that growth further improves governance. Mauro notes “a consensus seems to have emerged that corruption and other aspects of poor governance and weak institutions have substantial, adverse effects on economic growth.” Hall and Jones, who found large productivity differences across countries, conclude, “our hypothesis is that differences in capital accumulation, productivity, and therefore output per worker are fundamentally related to differences in

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social infrastructure across countries.... In fact [our] central hypothesis...is that the primary, fundamental determinant of a country’s long-run economic performance is its social infrastructure. By social infrastructure we mean the institutions and government policies that provide the incentives for individuals and firms in an economy.”

There are extensive econometric studies that show strong correlation between long-term economic performance and good governance. In other words, the quality of governance fundamentally determines long-run developmental outcomes.\(^2\) Kaufmann and Kraay draw on a large World Bank data set designed to measure the link between governance and development, and to monitor the performance of countries. They track the quality of governance from 1996 to 2003 in some two hundred countries.\(^4\) The quality of governance is divided into six categories aimed at capturing how governments are selected, monitored, and replaced; a government’s capacity to formulate and implement sound policies; and the respect of citizens and the state for the institutions that govern them. The six measured indicators are: (a) voice and accountability; (b) political stability and lack of violence; (c) government effectiveness; (d) regulatory quality; (e) rule of law; and (f) control of corruption. The authors conclude that good governance is not only critical to development but also that it is the most important factor in determining whether a country has the capacity to use resources effectively to promote economic growth and reduce poverty.\(^5\) Similarly, Roll and Talbott estimate that governmental institutions and policies explain most of the variation across nations in terms of economic


\(^4\) Associated with the growing demand for quantifying the governance performance of countries, a number of data sets measuring quality of institutions, governance, and corruption have been created. These include the worldwide aggregate Governance Indicators Dataset, generated by researchers at the World Bank, comprising six different governance components for about two hundred countries, by the Corruption Perception Index of Transparency International, and by the measures generated from enterprise surveys carried out by the World Bank and the Global Competitiveness program of the World Economic Forum.

development—with secure property rights, business transparency, political rights, civil liberties, and stable rule of law as significant factors accounting for developmental success.\footnote{Richard Roll and John R. Talbott, “Political Freedom, Economic Liberty and Prosperity,” \textit{Journal of Democracy} 14, no. 3 (July 2003): 75-89.}

Not surprisingly, the importance of good governance has now become an article of faith, with multilateral organizations, donors, and lenders increasingly basing their aid and loans on the condition that policies that ensure good governance are adopted.\footnote{World Bank, \textit{Global Monitoring Report 2005: Millennium Development Goals: From Consensus to Momentum} (Washington, DC: World Bank, 2005); World Bank, \textit{Globalization, Growth and Poverty: Building an Inclusive World Economy} (New York: Oxford University Press, 2000); World Bank, \textit{Global Development Finance 2002} (Washington, DC: World Bank, 2002); and World Bank, \textit{World Development Report 2002: Building Institutions for Markets} (New York: Oxford University Press, 2002).} But, what is good governance? Since creating the political and social framework conducive to economic growth is often the greatest challenge many countries face—what types of policies and institutions have the most positive and measurable effects on improving governance? As a corollary, what kinds of institutional arrangements are associated with growth and poverty reduction? How best to promote and sustain good governance, especially in the world’s poorest countries? These and related issues are discussed in the following sections.

\section*{Good Governance}

Broadly speaking, the term governance encompasses all aspects of the way a country is governed. Good governance has several characteristics. It is participatory, consensus oriented, accountable, transparent, responsive, effective, efficient, equitable, and inclusive and follows the rule of law. At a minimum, good governance requires fair legal frameworks that are enforced impartially by an independent judiciary and its decisions and enforcement are transparent or carried out in a manner that follows established rules and regulations. Since accountability cannot be enforced without transparency and the rule of law, accountability is a key requirement of good governance. Not only governmental institutions, but also private sector and civil society organizations must be accountable to the public and to their institutional stakeholders.\footnote{Civil society, composed of nongovernmental organizations, faith-based groups, trade unions, indigenous people’s groups, charitable organizations, professional associations, and private foundations, has emerged as a major force in international development in the past two decades. The dramatic growth of civil societies has been aided by the expansion of democratic governance and globalization. Societal groups, by mobilizing thousands of supporters around the world, have played an important role in shaping global public policy—exemplified by successful advocacy campaigns involving such issues as the banning of land mines, debt cancellation,
that all its members feel that they have a stake in it, good governance requires that institutions serve all stakeholders fairly.

The United Nations Millennium Project, the United Nations Development Programme’s *Human Development Reports*, and the World Bank’s annual *World Development Reports* each list over one hundred “must do” items for countries to achieve good governance.\(^9\) Even allowing for the considerable overlap among the various items, it is a formidable agenda—not only for the world’s least developed and post-conflict countries, but also for many middle-income and transitional economies. However, the reports provide little prioritization or guidance regarding what governance items are essential and what can wait, how they should be sequenced and implemented, how much they will cost and how they will be paid for. They also suffer from flaws typical to commissioned reports: a tendency to provide “one-size-fits-all” prescriptions, despite the fact that research shows, although governance reforms share commonalities, they must also be judiciously determined on a country-by-country basis—the institutional innovations tailored to local political and institutional realities, with the most essential sequenced in first.

The various report recommendations can be broadly divided into two sections: the *general* and the *substantive*. The general emphasize “capacity development,” which includes both the building of effective states (which can deliver public goods and services to the populace and ensure peace and stability), and an empowered and responsive society which can hold states accountable for their actions. The reports correctly note that poor or inadequate governance may not always be the result of venal or rapacious leadership, but because the state may suffer from weak formal political institutions and lack the resources and capacity to manage an efficient public administration. However, what is not always appreciated is that good governance cannot be had on the cheap—simply through the implementation of bureaucratic and administrative policies.

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Moreover, governance reforms without concomitant economic reforms are doomed to failure. Again, research shows that political-institutional reforms are more successful in settings where economic development already has started to take place. This is not to imply that political development is simply a consequence of economic development, but to underscore that institution building and consolidation are more likely to succeed where development already has taken place, or is taking place. Arguably, many of the items listed on the good governance agenda as preconditions for development are actually consequences of it. The implications are profound: institution building and the promotion of good governance demand simultaneous commitment to economic development. Finally, measuring good governance and overall governmental performance generally requires measuring what Rotberg calls “outcomes” and not just “inputs.” That is, what needs to be measured is the government’s delivery of public goods and not just its budgetary provisions, its actual accomplishments, and its good intentions.

Substantively, the reports view institution building, democracy, and political-economic decentralization as essential for good governance and economic development. Although intuitively appealing, the questions of precisely how each contributes to democratic institutionalization and economic development are poorly understood—and the reports’ overly sanguine rhetorical statements shed little light on these issues. For example, how does a society devise an institutional framework that nurtures both democracy and market economies; how does it best ensure that government has sufficient power to provide security and public services, while being inhibited from predation on its own citizenry; how can democratic governance, economic growth, and human development become mutually reinforcing; or, how does a society prevent the devolution and decentralization of political-economic authority from exacerbating regional or particularistic divisions? Although the reports do not provide a nuanced discussion of these issues, a growing body of research sheds useful insights into these important issues. The following sections draw on this scholarly research to elaborate these concerns.

Institutions and Good Governance
In his latest book, Understanding the Process of Economic Change, Nobel laureate Douglass North reiterates that good institutions beget good governance. Institutions matter for both the long and short term because

they form the incentive structure of a society and provide the underlying determinants of economic performance. Institutions are composed of both formal (constitutions, laws, and regulations) and informal (such as social norms, customs, and traditions) rules that constrain human economic behavior. Specifically, institutions set the framework of rules and incentives that affect how people, organizations, and firms utilize resources in political and economic decisionmaking, or how they “play the game.” According to North, when incentives encourage individuals to be productive, economic activity and growth takes place. However, when they encourage unproductive or predatory behavior, economies stagnate.

While informal interpersonal exchanges and social networks can serve the needs of traditional societies, modern economies (given their specialization and complex division of labor) require formalized political, judicial, and economic rules. In providing specific rules of the game, political and economic institutions create the conditions that enable the functioning of a modern economy. That is, formal institutions, by securing property rights, establishing a polity and judicial system, and implementing flexible laws that allow a range of organizational structures, create an economic environment that induces increasing productivity. To North, institutions are “growth enhancing” because they reduce uncertainty and transaction costs.¹³ Thus, North’s paradigm is often labeled as the “new institutionalism” because it has at its core a set of ideas derived from the analysis of “transaction costs”—that is, costs that result from the imperfect character of real-world institutions and that have to be surmounted in order for economic activity to occur.

Specifically, the institutional framework affects growth because it is integral to the amount spent on both the costs of transactions and the costs of transformation inherent in the production process. Transaction costs are far higher when property rights of the rule of law are absent and not enforced. In such situations, private firms typically operate on a small scale and rely on extra-legal means to function. Conversely, an institutional environment that provides impartial third-party enforcement of agreements promotes exchange and trade because the parties know that a good or service will be delivered after it is paid for. Because institutions and the enforcement of rules largely determine the costs of transacting, good institutions can also minimize transaction costs—or costs incurred in making an economic exchange. Both political and economic institutions are necessary to sufficiently reduce transaction costs in order to make potential gains from trade realizable. North (and others)

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¹³ North cautions that uncertainty should not be confused with risk—which is quantifiable and even predictable—whereas uncertainty interferes with one’s ability to plan for the future.

confirms that, among the plethora of institutional rules, seemingly most critical to economic growth is the protection of private property rights.\textsuperscript{14} This is because property rights and contract enforcement are integral to reducing uncertainty in a market, owed to the fact that modern economies require property rights and effective, impersonal, contract enforcement. Conversely, personal ties, voluntary constraints, and ostracism are less effective in a large, complex, and impersonal economy.

North points out that every market is different and, to work efficiently, each market must find the right mix of formal and informal rules and the appropriate enforcement mechanisms. Moreover, what makes a market work well in a given period may not be appropriate over time, as critical elements such as technology, information costs, and political regimes can change, raising transaction costs. Therefore, economic performance is determined not only by the kind and quality of institutions that support markets, but also it depends largely on “adaptive efficiency”—or the political system’s effectiveness in creating institutions that are productive, stable, fair, broadly accepted, and flexible enough to be changed or replaced in response to political and economic feedback.

\textbf{Democracy and Economic Development}

Not only are political institutions necessary for economic development more likely to exist and function effectively under democratic rule, but also the adaptive efficiencies are best sustained in democracies because institution building to promote good governance and economic development is conterminous with democracy.\textsuperscript{15} It is no accident that countries that have reached the highest level of economic performance across generations are all stable democracies.\textsuperscript{16} In fact, one of the most robust findings of some two


decades of research on democratization is that durable democracy is strongly correlated with economic development, albeit, as Chong argues, there is some evidence of a “political Kuznets curve” in which the immediate effect of democracy is to exacerbate inequality, while the long-run effect is to diminish it.

Today, liberal democracy justifiably enjoys near-universal appeal and is regarded as the ideal system of government. According to the “procedural minimum,” liberal democracy is a form of government by means of which citizens, through open and free institutional arrangements, are empowered to choose and remove leaders in a competitive struggle for the people’s vote. According to Robert Dahl, the dean of democratic studies, a truly representative democratic government must be based on the principles of popular sovereignty; competitive political participation and representation; an independent judiciary; free, fair and regular elections; universal suffrage; freedom of expression and conscience; the universal right to form political associations and participate in the political community; inclusive citizenship; and adherence to the constitution and the rule of law.


17 At least, statistically, Przeworski and his co-authors have noted that democracy is most likely to flourish and survive when a country enjoys more than $5,500 per capita GNP. Adam Przeworski, Michael E. Alvarez, Jose Antonio Cheibub, and Fernando Limongi, *Democracy and Development: Political Institutions and Well Being in the World, 1950-1990* (New York: Cambridge University Press, 2000); and Adam Przeworski and Fernando Limongi, “Modernization: Theories and Facts,” *World Politics* 42, no. 2 (April 1997): 155-183. Also see, Sylvia Chan, *Liberalism, Democracy and Development* (New York: Cambridge University Press, 2002).


19 Scholars often distinguish between the “procedural” and “substantive” definitions of democracy. Procedural or formal democracy focuses on democratic institutions, structures, and procedures, while substantive democracy centers on democratic conditions and how to achieve the substantive goals of democracy, such as liberty, economic equality, and redistributive justice.

20 Of course, this comprehensive list is not easy to meet. In his earlier writings, Dahl utilized the concept of polyarchy rather than democracy because of his view that no government ever becomes fully democratic. Thus, polyarchies are those governments that approach democratic norms and practices. To Dahl, a country can be considered “democratic” if there is contested election based on universal franchise, as well as civil and political freedoms of speech, press, assembly, and organization. Robert Dahl, *Polyarchy: Participation and Opposition* (New Haven, CT: Yale University Press, 1971). Arend Lijphart, *Democracies: Patterns of Majoritarian and Consensus Government in Twenty-One Countries* (New Haven, CT: Yale University Press, 1984), has identified as many as nine different types of democratic political systems on the basis
Scholars have long argued that democracies have embedded institutional advantages that support economic development.\textsuperscript{21} According to Nobel laureate Amartya Sen, democracies enrich individual lives through the granting of political and civil rights, and do a better job in improving the welfare of the poor, compared to alternative political systems.\textsuperscript{22} Second, they provide political incentives to rulers to respond positively to the needs and demands of the people.\textsuperscript{23} That is, democracies are seen to be responsive to the demands and pressures from the citizenry, since the right to rule is derived from popular support manifested in competitive elections—or as Robert Dahl long ago noted: governmental responsiveness to citizens’ demands is built into periodically held electoral contests guaranteed by juridically protected individual rights.\textsuperscript{24} Numerous studies corroborate this. For example, an analysis of forty-four African states by Stasavage finds strong evidence that democracy helped to increase government spending on education.\textsuperscript{25} Similarly, Avelino, Brown, and

of two dimensions of majoritarian-consensus democracy. Lijphart argues that new democracies should build political institutions along consensual lines because consensus democracies promote both shared responsibility among groups at the national level and autonomy at the state-level. In his later work, Lijphart, through more detailed empirical analysis, showed that consensus democracies are associated with higher levels of social and economic performance and democratic quality than majoritarian systems. Arend Lijphart, \textit{Patterns of Democracy: Government Forms and Performance in Thirty-Six Countries} (New Haven, CT: Yale University Press, 1999). Karl and Schmitter have identified three types of democracy: conservative, corporatist, and competitive—on the basis of whether a nation’s party system is restrictive, collusive, or competitive. Terry Lynn Karl and Philippe Schmitter, “What Democracy Is...And Is Not,” \textit{Journal of Democracy} 2, no. 3 (Summer 1991): 75-86. Przeworski defines democracy as a system of processing conflicts in which parties that lose elections accept this outcome and wait for the next election, rather than try to destroy the regime to attain their goals. Adam Przeworski, \textit{Sustainable Democracy} (New York: Cambridge University Press, 1995), and id., \textit{Democracy and the Market: Political and Economic Reforms in Eastern Europe and Latin America} (New York: Cambridge University Press, 1991).

\textsuperscript{21} As Dahl notes, “by the end of the twentieth century, although not all countries with market economies were democratic, all countries with democratic political systems also had market economies.” Dahl, \textit{On Democracy}, 58.


\textsuperscript{24} Classical thinkers such as John Locke, John Stuart Mill, and Alexis de Tocqueville not only viewed democracies as the embodiment of reason and advancement, but also assumed that liberal democracies would greatly empower the laboring and disadvantaged sectors of society to press successfully to redress the gross socioeconomic and political disparities.
Hunter find that democracy is robustly linked to higher spending on health, education, and social services.\textsuperscript{26} Third, the open dialogue and debates inherent in open democracies aid in the development of values and priorities, and this “constructive function” of democracy can be very important for equity and justice. Amartya Sen notes that this explains, for example, the remarkable fact that, in the terrible history of famines around the world,

...no substantial famine has ever occurred in any independent country with a democratic form of government and a relatively free press. Famines have occurred in ancient kingdoms and contemporary authoritarian societies, in tribal communities and in modern technocratic dictatorships, in colonial economies run by imperialists from the north and newly independent countries of the south run by despotic national leaders or by intolerant single parties. But they have never materialized in any country that is independent, that goes to elections regularly, that has opposition parties to voice criticisms, and that permits newspapers to report freely and question the wisdom of governments’ policies without extensive censorship.\textsuperscript{27}

Fourth, as is well known, there is a distinguished body of scholarship that has long claimed an “elective affinity” between authoritarianism and economic development (read industrialization)—implying that rapid industrialization necessitates the discipline and autonomy that only an authoritarian regime can provide.\textsuperscript{28} The most recent articulation of this argument is presented in Atul Kohli’s meticulously researched \textit{State-Directed Development}.\textsuperscript{29} Kohli


\textsuperscript{27} Amartya Sen, \textit{Development as Freedom} (New York: Oxford University Press, 1999), 152.


\textsuperscript{29} Atul Kohli, \textit{State-Directed Development: Political Power and Industrialization in the Global Periphery} (New York: Cambridge University Press, 2006).
examines the reasons why developing countries succeed or fail to industrialize. He argues that building an effective or “autonomous” state is paramount because, without effective state capacity, political and economic elites cannot pursue coherent industrialization policies. Through a detailed examination of the process of industrialization in South Korea, Brazil, India, and Nigeria, Kohli provocatively argues that building state capacity may be achieved under either authoritarian or democratic regimes. Of course, Kohli’s basic argument is not new. As noted earlier, in the case of East Asia, a large body of research has highlighted how the “embedded autonomy” of the authoritarian Chiang regime in Taiwan and the Park Chung Hee regime in South Korea enabled these regimes to achieve a relatively high degree of insulation from the dominant interests in civil society and to actively shape the economy and society. Specifically, it is argued that these “hard” developmental states, through a system of elaborate corporatist organization of interest groups—a strategy that granted considerable operational space to market-oriented technocrats and policy elites, and allowed paternalistic collaboration with the powerful business conglomerates in the private sector—enabled these states to pursue market-conforming methods of state intervention in the economy, without precipitating organized opposition from the powerful vested interests. Using different conceptual categories (but familiar logic), Kohli labels the Park Chung Hee regime as a “cohesive-capitalist state,” guided by a strong centralized government and a professional and meritocratic bureaucracy. Such a state, by effectively insulating itself from the parochial demands of both the elite and popular masses, is able to intervene in the economy to promote rapid industrialization.

No doubt, the experiences of the proverbial developmental states of East Asia (Singapore, South Korea, and Taiwan) offer evidence that efficacious state capacity and good governance can be achieved in developmental authoritarian regimes—albeit, not in predatory authoritarian systems. Yet, it is also recognized that authoritarian regimes that are “developmental” are an exception rather than the rule, as authoritarian regimes are more conterminous with pathologies such as predation and expropriation. Minxin Pei makes precisely such a case with reference to the PRC—which at first glance has all the attributes of a developmental state, but is not. Pei’s examination of the sustainability of the Chinese Communist Party’s developmental strategy—that of pursuing promarket economic policies under dictatorial one-party rule—leads him to a number of novel conclusions. Perhaps, most provocatively, Pei refutes the conventional view which sees the Chinese model as reminiscent of the East Asian “developmental state.” Rather, unlike East Asia’s strong states,

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the Chinese state has become systematically more predatory—especially under the post-1990 reforms. Specifically, as property rights and administrative power were decentralized, local party bosses gained great discretion in appropriating, or more appropriately, stripping, state assets for themselves and their cronies—at the expense of the state. As the reach of the central state declined and power and “autonomy” of local party bosses and the provincial and regional elites increased, they began to engage in an orgy of self-aggrandizement. As more and more “exit options” have become available, especially business opportunities (both legal and illicit), it has only further reduced their stake in the system—thereby increasing their incentive to maximize their incomes and rents as quickly as possible. Thus, rather than a developmental state, China is being morphed increasingly into a “decentralized predatory state.” Given these ominous patterns, Pei casts doubt on conventional explanations regarding viability of the Chinese model: that sustained economic expansion will lead to political liberalization and democratization or that a “neo-authoritarian developmental state” is essential to economic take-off. As he points out, the lack of democratic reforms in China has led to pervasive corruption and a breakdown in political accountability. Ironically, China’s decentralized predatory state under the strength of its economic fundamentals hides more than it reveals. Pei warns that, only when the growth rate begins to taper off, the real extent of predation, including the serious human, material, environmental, and welfare costs, will become evident. If in East Asia, correcting the negative legacies of authoritarianism fell to incipient democratic regimes, in China, where Pei fears that the “illiberal adaptation” by elites will limit political liberalization, such an outcome seems implausible.

Moreover, democracies, unlike authoritarian regimes, offer a better long-term protection of property rights as well as individual and collective freedoms. Indeed, Robert Barro’s cross-country study finds only three former dictatorships in the world (Chile, Singapore, and South Korea) that had not engaged in any expropriation. Also, as noted, recent research on the authoritarian legacies in East Asia has questioned the “human developmental outcomes” of these developmental states. David Kang’s important book, *Crony Capitalism: Corruption and Development in South Korea and the Philippines,* compelling shows that authoritarian regimes, including the erstwhile developmental ones such as South Korea—once they were well-entrenched—rarely showed any concern for the greater public good and long-term growth. Similarly, in his well-crafted book aptly titled *Healthy Democracies,* Joseph Wong discusses how democratization in Taiwan and South Korea fundamentally altered the

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incentives and ultimately the decisions of top policymakers toward health care. He compellingly points out that, during the long period of authoritarian rule, the “insulated” state elites in both countries could choose (and often did) to pursue selective, if not arbitrary, social welfare policies. Contrary to popular belief, under authoritarian rule, health care accessibility was piecemeal and “health care policy outcomes far from universal.” However, Wong notes that the transition toward democracy in both countries dramatically changed the political imperatives of social policy reform. Vote-seeking politicians needing to promote popular policies aligned themselves with health-care reform advocates, including grass-roots activists, to push top-level bureaucrats to implement reformist programs and policies. The end result is that there is a qualitative difference between health care (including other welfare measures) under authoritarian rule and since democratization. In Wong’s view, greater democratic participation in Taiwan and South Korea literally has led to a revision of the social contract between the state and popular classes. His research underscores how democratic political competition in South Korea and Taiwan has compelled the state to redirect its energy away from simply narrow conceptions of economic development (meaning rapid industrialization) to address quality-of-life issues such as health care and education, among other welfare-enhancing measures.

Fifth, it is now irrefutably clear that, contrary to earlier claims, there is no “trade-off” or “cruel choice” between democracy and development. Rather, a responsive democratic state is essential for economic development. Empirical and qualitative research comparing economic growth under both democratic and authoritarian settings has found anomalies in the core assumption of the

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35 Samuel Huntington and Joan Nelson, No Easy Choice: Political Participation in Developing Countries (Cambridge, MA: Harvard University Press, 1976). Huntington and Nelson noted a “cruel choice” between democracy and development. Specifically, they argued that, since socioeconomic modernization increases the political participation of citizens without ensuring that their demands can be met, economic development is best promoted under conditions of “a high degree” of political stability and order. In settings where elites lack in the “art of associating together” and institutions are unable to channel the chaos that accompanies modernization, democracy can be counterproductive since it has the potential to open and destroy the already fragile political institutionalization. In such settings, popular participation makes democracies ungovernable, as pluralism tends to create more divisions and encourage consumption at the expense of investment. Hence, contrary to the “assumptions of liberal, technocratic and populist models...in the early stages of development, the expansion of political participation tends to have a negative impact on economic equality” (p. 75). Olson, drawing on the political-economy literature, argued that, since special-interest groups unduly influence state policy to advance their particularistic interests, democracy would only exacerbate this problem, given that it provides interest groups with a wide scope for organization and lobbying. Mancur Olson, The Rise and Decline of Nations: Economic Growth, Stagflation and Social Rigidities (New Haven, CT: Yale University Press, 1982).
The cruel choice hypothesis. In particular, no convincing evidence supports the claim that authoritarian suppression of political and civil rights is helpful in encouraging economic development—even if development is identified simply with economic growth. Intercountry comparisons have contradicted the thesis of any conflict between political freedoms and economic performance. Rather, the data show that the frequently made casual generalizations about the negative impact of democracy on economic growth are simply assumptions because the actual directional linkages are tentative and seem to depend on many other factors. Kohli notes that the “developmental performance of Third World democratic regimes [India, Malaysia, Sri Lanka, Venezuela, and Costa Rica] must be judged satisfactory.”

In their comprehensive study aptly titled The Democracy Advantage: How Democracies Promote Prosperity and Peace, Halperin, Siegle, and Weinstein further confirm the above assessments. Their results, based on a survey of over one hundred rich and poor countries, compellingly show that democracies outperform (in terms of economic development) autocracies or quasi-authoritarian polities—despite the fact that several autocracies, including North Korea, Iraq, Afghanistan, and Cuba, were not included in the sample because of the lack of reliable data. Suffice it to note, the actual growth figures for autocracies would be substantially lower if the “performance” of these countries were included. The data unequivocally show that both developing country democracies and nondemocracies have grown at approximately 1.5 percent of GDP per capita per year since the 1960s, only when the high-performing East Asian economies (specifically, Taiwan, South Korea, Singapore, and Hong Kong) are included in the sample. However, when these countries are excluded, the performance of democracies is better—growing at 0.5 percent per capita per year faster than autocracies and mixed polities. Furthermore, democracies outperform autocracies in the consistency of their growth. That is, an analysis of the eighty worst economic performers of the last forty years reveals that all but three have been autocracies. The authors note that the range of developmental experiences among democracies can be explained by the differing success each has had with institutional development.

39 Of course, there is the counterfactual. The editor of this journal, Professor T. J. Cheng, correctly pointed out that, if we exclude the “very bad (i.e., truly predatory) authoritarian regimes—and there are quite a few, such as Mobuto’s Zaire, Duvalier’s Haiti, Somoza’s Nicaragua, Ne Win’s Burma, and so on—then the average growth rates of nondemocratic regimes are not necessarily far behind that of the democratic regimes.” I thank the editor for this insight.
In fact, both autocracies and democracies with more robust institutions have enjoyed higher rates of economic development than countries without well-established institutions. This explains why some of the former East Asian autocracies performed better than some democracies.

Sixth, the claim that poor democracies, including the nascent democracies in the developing world and in post-communist transition settings, are ill-equipped to implement needed economic reforms cannot be sustained. Specifically, it has been argued that because neo-liberal or market reforms carry with them attendant short-term pain such as rising unemployment, inflation, higher prices on state subsidized goods, falling wages, and other austerity measures, political reformers find it difficult to generate popular support. Because governments, especially democratically elected ones, cannot afford such popular backlash, the reforms are usually watered-down or altogether abandoned. Indeed, Adam Przeworski, in his important book, *Democracy and the Market*, predicted that economic reforms introduced in new democracies would produce populist policies that would undermine both the economy and democracy. Other analysts have highlighted the probable coalitions against reform, arguing that vested rent-seeking beneficiaries of protectionist, state-led developmental strategies often mobilize through democratic channels to block reforms. On the other hand, since the beneficiaries of reform are presumed to be widely dispersed and unorganized, they cannot counter the vested interests. Again, the political implications were that reforms were likely to be unpopular and politically costly and elected politicians, including well-intentioned democratic governments, would understandably do what was politically expedient, but fiscally irresponsible—delaying or altogether scuttling necessary economic reforms.

However, actual experience belies such pessimistic assessments. For starters, until the 1980s, most countries in Latin America and sub-Saharan Africa were governed by repressive authoritarian regimes, the majority of which proved incapable of implementing the far-reaching economic and political reforms they promised when seizing power. Arguably, it was the poor performance of these authoritarian regimes (including communist regimes in Eastern Europe) that explains the dramatic shift toward civilian governments in these regions. In fact, one of the most interesting research findings was the so-called “post-communist paradox”—that among post-communist countries, it was precisely the most democratic regimes that carried out the most comprehensive economic reforms, whereas the more authoritarian ones proved largely incapable. That is, frequent elections, unpredictable executive


tenure, and growing societal pressures did not prevent countries such as the Baltic states and Poland from implementing radical macroeconomic reforms, whereas the more authoritarian Belarus, Ukraine, Moldova, and the regimes in the Caucasus and Central Asia not only failed to do so—but given the fact that authoritarian leaders in these countries have few checks on arbitrary power, they also engaged in cronyism and corruption.\textsuperscript{42}

Evidence from a poor democracy such as India is also illustrative. Jenkins claims that, in practice, the Indian state has a far greater degree of autonomy than is assumed by theorists who claim that a democratic state can be easily compromised and captured by particularistic groups, lobbies, dominant-class coalitions, and other vested interests.\textsuperscript{43} To the contrary, he argues that India’s “real” functioning democratic state (unlike the idealist theoretical conceptions of it) is actually made up of a rather loose, fluid, and frequently changing conglomeration of interest groups. This reality on the ground gives the state much flexibility and autonomy over policy issues. According to Jenkins, nothing underscores this more vividly than the introduction of economic reforms in 1991 and their continued sustainability. He asks (1) why and how India’s governing elite, long-wedded to a statist-cum-protectionist economic program, suddenly abandoned this in favor of integrating India into the global economic system; (2) how the governing elite succeeded in “selling the benefits of reform to individual constituencies and the public at large,”\textsuperscript{44} and (3) how the elite went about implementing their ambitious economic reform agenda.

To Jenkins, the answers to these questions lie in appreciating the mechanisms under which “real democracy” functions in India—which he argues can best be understood as “incentives,” “institutions,” and “skills.” With regard to incentives, India’s mercurial political elites are willing to take risks (i.e., to introduce reforms) because they have correctly calculated that reforms will not endanger their political and electoral survival. They know the rules of the game well enough to develop new avenues for collecting rents, distributing patronage, and, given the highly fluid and fragmented nature of interest groups, creating new coalitions for reform, including dividing and isolating interests opposed to reform. Similarly, India’s political institutions, both formal (federal structure) and informal (political party networks), work in ways that help the political elites to implement reforms with surprising ease. The federal structure, which forces the provincial governments (called


\textsuperscript{43} Rob Jenkins, \textit{Democratic Politics and Economic Reform in India} (New York: Cambridge University Press, 1999).

\textsuperscript{44} Ibid., 3.
states) to compete with each other, prevents the states from uniting against the reforms, not to mention the fact that politically costly reforms are often devolved to these state-level governments. Further, the clientelist and porous nature of India’s political parties—in which the boundaries between party and nonparty networks are blurred—allows politicians to create multiple channels of influence and patronage, besides co-opting and accommodating diverse interests. The “skills” include the tactics party elites and individual politicians use to “sell” the reforms to their constituencies, indeed, to the general public. More often than not, they “employ political tactics that have little to do with ‘transparency’ in order to soften the edge of political conflict by promoting change in the guise of continuity.”

In other words, the tactics used are often underhanded and deceptive—what Jenkins calls “reform by stealth”—in order to lull the electorate into accepting the more unpalatable aspects of neoliberalism. Jenkin’s study compellingly shows that democracies can be far more dexterous and capable in formulating and implementing policies than they generally are given credit for.

Moreover, research confirms that new democracies with cohesive party systems, strong executives, and insulated economics ministries and central banks, as well as those operating under coalition governments and fragmented party systems (but with responsive political institutions), have demonstrated capacity to implement economic reforms. Beginning in the 1980s, a number of democratic regimes, including fragile and “uninstitutionalized” new democracies in a number of developing and transition economies, have enacted far-reaching market reforms—despite the high short-term costs they have imposed on powerful domestic groups, including larger segments of society. These democratic governments have been able to build coalitions across social groups through targeted policy measures. For example, Roberts and Arce note that, in Peru, the government, through its strategically targeted economic programs to key constituencies, especially the working poor, was able to garner popular support for market reforms—including during periods of severe economic contraction.

Similarly, Kurtz notes that, in Chile and Argentina, “a democratic government was able to push through and consolidate a package of economic liberalizations far more ambitious than those even a previous savage bureaucratic authoritarian government was unable to impose, and more extensive than those undertaken in the East Asian newly industrializing countries

45 Ibid., 52.
over the course of decades.”\textsuperscript{48} It is now recognized that new democracies were able to do all this because popular societal actors had the opportunity to exert pressure for reforms through lobbies, the media, networks of nongovernmental organizations, legislative representatives, and the courts (to challenge the constitutionality of various laws), in addition to having greater associational autonomy from the state. This not only has allowed new democracies to pursue reforms without resorting to the draconian measures of their authoritarian predecessors, but also to better amplify the voices of the popular sectors in policy decisions—and despite, at times, domestic and external pressures, to have a better track record in providing safety-nets to the vulnerable and those hurt most by market reforms. Not surprisingly, there is general consensus now that the implementation of the more exacting “second-generation reforms” (such as flexible labor markets, tax reform, capital account opening, banking and financial sector reforms, anticorruption measures, improved corporate governance, competent bureaucracy, and targeted poverty reforms, among others) require political deftness and finesse that only representative democratic regimes can muster.

\textit{Democracy and Good Governance}

Many observers mistakenly assume that the establishment of a democratic regime will also lead to the swift consolidation of democratic institutions and procedures.\textsuperscript{49} However, cross-national country experiences show that the \textit{ancien regime} tightly bound by its own administrative and bureaucratic culture and traditions can be remarkably impervious to change. Moreover, democratization does not always mean a rupture with the past, suggesting that a formal democratic order can persist alongside authoritarianism, elitism, and social exclusion. Thus, the process of democratic consolidation can be long and arduous—as democracies can deepen, but also can remain partial, deteriorate, or altogether break down. In their original study, O’Donnell and Schmitter pointed out that the pattern of transition can profoundly determine the extent of democratization.\textsuperscript{50} The most successful are “pacted transitions”


\textsuperscript{49} Schedler argues that a democratic regime is consolidated when leaders behave democratically, when major political actors acquire democratic attitudes, and when the socioeconomic and institutional foundations for democracy are in place. Andreas Schedler, “Measuring Democratic Consolidation,” \textit{Studies in Comparative International Development} 36, no. 1 (2001): 56-76. Also see, Juan Linz and Alfred Stepan, \textit{Problems of Democratic Transition and Consolidation: Southern Europe, South America and Post-Communist Europe} (Baltimore, MD: John Hopkins University Press, 1996).

between “soft-liners” in the *ancien regime* and moderates in civil society. However, where one side is more powerful than the rest, it will dictate the rules. If the powerful happen to be autocrats (which often is the case), the pattern of transition will be autocratic. When the distribution of power between “autocrats” and “reformers” is more equal, an unstable regime is most often the outcome.\(^{51}\)

Overall, almost a quarter century after the beginning of the third wave of democratization, the quality of democracy remains poor in most settings. The reality on the ground tends to support Zakaria’s pessimistic assessment that, while “democracy is flourishing; liberty is not.”\(^{52}\) What explains this paradox and what can be done to correct it? Reminiscent of what O’Donnell earlier called “delegative democracy”\(^{53}\) and Diamond called “hybrid regimes,”\(^{54}\) where electoral democracies combine authoritarian practices, Zakaria notes that, although the idea of democracy (in the sense of devolution of power to the masses) has spread rapidly, it is much less clear the extent to which democratic consolidation or the institutionalization and routinization of democratic norms and values within the political system is taking place. Rather, in most settings, the result is often the emergence of what Zakaria terms “illiberal democracies”—a form of governance which deliberately combines the rhetoric of liberal democracy with illiberal rule.\(^{55}\) For example, although

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51 McFaul lists seven factors for successful democratic breakthrough in post-communist settings. These include, “(1) a semi-autocratic rather than fully autocratic regime; (2) an unpopular incumbent; (3) a united and organized opposition; (4) an ability quickly to drive home the point that voting results were falsified; (5) enough independent media to inform citizens about the falsified vote; (6) a political opposition capable of mobilizing tens of thousands or more demonstrators to protest electoral fraud; and (7) divisions among the regime’s coercive forces.” Michael McFaul, “Transitions from Post-Communism,” *Journal of Democracy* 16, no. 3 (July 2005): 7.


53 Guillermo O’Donnell, “Delegative Democracy,” *Journal of Democracy* 5, no. 4 (January 1994): 55-69. According to O’Donnell, “delegative democracies” are characterized by low levels of horizontal accountability (checks and balances) and, therefore, exhibit powerful, plebiscitarian tendencies and dominant executives. Delegative democracies are found in societies where economic crises and institutional weaknesses allow such personalist leaders to govern arbitrarily.


regular, competitive, multiparty elections are held, qualifying the country as an “electoral” democracy, the everyday practices of the state are marked by arbitrariness and abuses. Similarly, political freedoms and civil rights may be formally recognized, but hardly observed in practice; the judiciary, officially deemed independent, is easily compromised; and the free press is harassed in numerous ways. Zakaria notes that, even in established democracies such as India, democratization has meant “opening up its politics to a much broader group of people who were previously marginalized,” creating new political parties that have made India “more democratic,” but “less liberal.” Thus, illiberal democracy (that is, nominally democratic government shorn of constitutional liberalism and institutional checks), is not only potentially dangerous—bringing with it the erosion of liberty, the abuse of power, ethnic divisions, and conflict—but also “illiberal democracy has not proved to be an effective path to liberal democracy.”

Zakaria provocatively argues that the most effective way to turn developing or traditional societies into liberal democracies is by first fostering constitutional liberty rather than democracy. This is because, if electoral democracy is established before a society has achieved constitutional liberty, it is likely to end up as an illiberal democracy or degenerate into authoritarianism. To Zakaria, liberty leads to democracy and democracy ends up undermining liberty. As an illustration, he argues that, if free elections were held in Islamic countries, most fundamentalist parties would win and then proceed to destroy liberty—“it would be one man, one vote, one time.”

To Zakaria, “liberal authoritarian regimes” such as in Singapore and formerly in South Korea, Taiwan, and Chile, are best suited to create the constitutional liberal infrastructure from which democracy eventually can emerge. No doubt, to label authoritarian regimes that once ruled Taiwan, South Korea, or Chile as “liberal,” or to generalize complex country experiences, is not persuasive. It seems to me that it was the pressures from civil society that pushed these authoritarian regimes toward greater political opening and eventually democratization rather than the inherent liberalism of these regimes. Also, as discussed earlier, the case of the PRC illustrates that one-party rule does not always create the conditions for democracy. As Carothers insightfully points out, the “sequencing fallacy” “rests on the mistaken two-part premise: that a significant number of autocrats can and will act as generators of rule-of-law development and state builders and that democratizing countries are inherently ill-suited for these tasks.” It seems that, while Zakaria’s analysis is plausible, his prescriptions are not.


48 | Taiwan Journal of Democracy, Volume 3, No.1
Arguably, constitutional liberty and democracy are not always antithetical, but could reinforce one another. It seems to me that the “restoration of balance” which Zakaria wants can best be achieved through political moderation that simultaneously builds both constitutionalism and democracy. Specifically, if illiberal tendencies are to be restrained, political moderation is necessary. However, moderation requires most critically effective democratic institutions and structures that can restrain illiberal, populist, and crudely majoritarian practices. At the minimum, democratic structures such as parliaments and legislatures must represent the interests of all citizens and provide a system of checks and balances, as well as oversee and impose clear constitutional limits on executive authority. Such limits are necessary against the corrupting effects of power. Also, the judicial and legal institutions must be independent of special influences, and protect the political and civil rights of all citizens. They must provide equal protection to women, minorities, and other subordinate groups and fair access to judicial and administrative systems, and be accountable to the public—including allowing citizens to seek protection of their rights and redress against government actions.

Moderation is absolutely critical in fractious multiethnic and plural societies, indeed, in the emerging democracies as a whole, where political competition among the various contending groups often becomes an uncompromising winner-take-all battle, with the numerically larger groups using elections and other legitimate democratic forms to pursue particularistic interests or to ensure their dominance—the so called “tyranny of the majority.” In such settings, to view “democracy” simply in terms of elections and majority rule before the institutions and norms essential for the functioning of democracy are established, is misguided and has the potential to exacerbate long-festering social feuds and cleavages, producing illiberal results. The most effective way to moderate political competition and mitigate divisions is to create meaningful disincentives to the formation of factionalized political groupings, led by itinerant demagogues and popular majorities based on narrow communal, ethnic, religious, or other group-based identities. To achieve this, the constitutional provisions and electoral systems must be deliberately engineered to promote the public good by encouraging genuine nationwide participation, negotiation, and compromise. To this end, political parties must seek support from a cross-section of groups and communities to gain power. Here, the cases of Nigeria and Indonesia are instructive. Nigeria requires political parties to include representatives of two-thirds of the country’s states on their executive councils.

As Horowitz notes, “by appealing to electorates in ethnic terms, by making ethnic demands on government, and by bolstering the influence of ethnically chauvinist elements within each group, parties that begin by merely mirroring ethnic divisions help to deepen and extend them.” Donald Horowitz, Ethnic Groups in Conflict (Berkeley, CA: University of California Press, 1985), 291.
and has made it illegal for parties to use communal and chauvinist references in their names and platforms. Similarly, Indonesia requires political parties to establish offices in two-thirds of the provinces nationwide, including a significant number of members in two-thirds of the districts and municipalities within these provinces in order to compete in parliamentary elections. In both countries, the electoral system has fostered moderation, leaving demagogues and firebrands isolated. In contrast, in Sri Lanka, the majority Sinhalese long-held monopoly on power, coupled with the maximalist demands put forth by both Sinhala and Tamil nationalists, has provoked a long and bloody civil war. Likewise, in the former Soviet Republic of Georgia, democratization resulted in civil war, as the minority Abkhaz feared that their distinct culture would be threatened by the Georgian majority. Hence, they resorted to armed resistance when it became clear that the unabashedly defiant group of Georgian nationalists would win the elections. Thus, the evidence is equivocal: federal arrangements that encourage the various stakeholders to work with elected officials from rival groups and communities can help forge more durable political alliances across groups, including electoral coalitions. Successful political cooperation is essential to protect group prerogatives in divided societies—thereby reducing tensions and keeping the peace.

Despite the claims of democracy advocates, the assumption that economic reforms under democracies would automatically lead to simultaneous income redistribution and rising living standards has proved to be overly sanguine. Rather, as noted earlier, there is evidence of a “political Kuznets curve,” in which the immediate effect of market reforms under democracy is to exacerbate inequality, while the long-run effect is to diminish it. This means that market reforms under democratic auspices are necessary conditions for promoting economic growth, but not sufficient ones to reduce inequalities—at least not in the short run. Experience suggests that simultaneous improvements in state capacity and institutions, accountability, representation, and governance are important factors in achieving economic growth with greater equity. Similarly, the conventional belief that there is a direct correlation between economic development and the emergence and durability of democracy is problematic. In his seminal research, Przeworski and his co-authors have challenged the claim that economic growth leads to democracy. Rather, they compellingly point out that growth has a measurable effect on the survival

rate of democracy, but not on the rate of its emergence. Specifically, they argue that the statistical relationship is as follows: when per capita income is $1,000 (measured in purchasing power parity), a democracy’s life expectancy is eight years. When per capita income is between $2,001 and $3,000, the life span of a democracy rises to twenty-six years. However, the authors note that when per capita income rises above $6,000, democracy gains permanence. Nevertheless, the authors caution that nondemocracies can persist above these income thresholds—meaning that nondemocracies can remain autocratic, despite rising income prosperity. The experience of the Peoples Republic of China and Southeast Asia lucidly underscores this observation. According to Dickson, in China, the evidence indicates that economic entrepreneurs, major beneficiaries, and party elites favor greater economic freedoms, but are not interested in democracy.63 Indeed, in Singapore, Malaysia, and Indonesia, political elites before the Asian crisis of 1997 used to argue that greater political openness and participatory institutions would undermine economic growth and growing prosperity. In fact, maintaining economic growth became the principal justification for authoritarianism—couched under labels such as “Asian democracy” and “Asian values.”

Democratic Nation and State Building
Some two decades ago, Robert Jackson distinguished between de jure and de facto states.64 However, many de jure states are in effect quasi-states, as they exist simply because other nations recognize them as legal sovereign entities, despite the fact that they lack many of the attributes of a functioning government. Today, these quasi-states are often interchangeably called “weak,” “failed,” “failing,” “collapsing,” “fragile,” “rogue,” or “post-conflict states,” among other terms. Regardless of the label, these states pose formidable problems for democratic governance, economic development, and global stability, as they are unable to provide effective legitimate rule or to deliver essential public goods such as security, law and order, education, and other essential services.65

65 “How do you know a failed state when you see one? Of course, a government that has lost control of its territory or of the monopoly on the legitimate use of force has earned the label. But there can be more subtle attributes of failure. Some regimes, for example, lack the authority to make collective decisions or the capacity to deliver public services. In other countries, the populace may rely entirely on the black market, fail to pay taxes, or engage in large-scale civil disobedience. Outside intervention can be both a symptom of and a trigger for state collapse. A failed state may be subject to involuntary restrictions of its sovereignty, such as political or economic sanctions, the presence of foreign military forces on its soil, or other military constraints, such as a no-fly zone.” “The Failed States Index,” Foreign Policy (July/August 2005): 56-66.
The World Bank has identified about thirty low-income countries as being “under stress”—albeit, some have put the number of weak or fragile states at around fifty.\(^{66}\) In such settings of lawlessness, violence, and impunity, where the “state” lacks even the most basic attributes of sovereignty, the challenge is to literally transform the “state” into an effective and responsible sovereign. But, how can this be done? Countless cases of failed democratization show that democracy cannot flourish under conditions of anarchy. As Rotberg notes, among a “hierarchy of political goods,” nothing is “as critical as the supply of security, especially human security.”\(^{67}\) Similarly, Fukuyama argues for “stateness first”—pointing out that “at the core of state-building is the creation of a government that has monopoly of legitimate power and that is capable of enforcing rules throughout the state’s territory.”\(^{68}\) Therefore, establishing political order and security is absolutely essential. Once order is established, the key is not only to empower citizens and their independent organizations, but also to simultaneously strengthen the nascent institutions of governance and the rule of law, as well as the development of formal representative organizations such as political parties—which constitute an essential link between citizens and the formal policymaking bodies.\(^{69}\) In some settings, it may also mean the formal state structures’ building partnership with a diverse range of local nonstate intermediaries and rival sources of authority to provide core functions such as public security, law and order, and conflict management—albeit, such formulas should only serve as a transitional phase toward consolidation of the formal governing bodies.

It is also important to reiterate that democratic state building cannot be had on the cheap. Given weak and failing states’ inability to raise revenue on their own, state building will require external sources of funding and logistical assistance—sometimes for extended periods. This means that the international community, especially the rich nations, must be willing to stay the course. However, as Carothers and others have argued, this does not mean that grandiose and overly ambitious nation-building plans are the answer.\(^{70}\) Rather, the goals should be well-targeted and expectations kept realistic, and second,


\(^{67}\) Rotberg, *When States Fail: Causes and Consequences*, 3.


nation or state building is not a technical exercise. Rather, every society will build institutions that are unique to its own culture, history, traditions, and ethnic makeup. Therefore, adapting to local traditions is essential. Moreover, Fukuyama’s caution to democratic nation-builders, that there is a difference between “state” and “nation” building, is worth keeping in mind. If a state is the government, a nation is that and much more because it also includes shared memories, culture, values, language, and a common sense of identity. Clearly, nation building is much more ambitious and challenging than state building. As Fukuyama notes, it is relatively easy to create an army or a police force, but to convince people divided by region, religion, or ethnicity to live together in the same society and have common interests is much more difficult.

Therefore, democratic state and nation building is a two-pronged process. At a minimum, it must include creating or strengthening core governmental institutions such as the security apparatus, judiciaries, economic agencies, and social-welfare systems, including education and health care. As Fukuyama argues, the first phase should involve stabilizing the country by establishing law and order, rebuilding basic infrastructure, and jump-starting the economy. The second phase must begin after stability has been achieved. This should include creating self-sustaining political and economic institutions that will ultimately permit democratic governance and economic growth to take place. Perhaps the best argument for such measured state building is that the alternatives are worse. It not only acts as a bulwark against grandiose and ultimately futile and costly experiments, such as in Iraq, but also it means that leaving fragile states to their own devices could renew civil wars and interstate conflict, making the long-term costs far heavier.

Finally, the governance deficit is a problem not only in weak and failed states. Many functioning states also face challenges to effective governance. To reverse this process and consolidate good governance and the rule of law requires building state capacity. In Linz and Stepan’s pithy observation, “democracy is a form of governance of a state. Thus, no modern polity can become democratically consolidated unless it is first a state.” Effective state capacity means that the institutions of governance are meritocratically organized and rule-based. This enhances the state’s ability to deliver public services, maintain a degree of regulatory oversight, enforce rules and regulations, and maintain social order. The experience of the East Asian newly industrializing nations vividly underscores this. East Asia’s “development states” played a

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crucial role in both growing the economy, while dramatically cutting poverty levels.

Like the “top-down” authoritarian East Asian developmental states, building effective democratic states means strengthening the states’ formal powers embodied in the executive and legislative branches so that they are able to translate diverse partisan preferences into effective policy options—either through majority rule or the establishment of viable coalitions. However, unlike the erstwhile East Asian states, it also means putting in place the rule of law with transparent standards, a fair electoral system that represents all stakeholders, and representative political parties that effectively convey citizen preferences. After all, markets cannot be expected to work effectively in the absence of political stability and the rule of law. Given their “adaptive efficiencies,” democratic regimes are indispensable because they can create an enabling environment for the market to function, besides providing more responsive and accountable governance. Such logic goes against the core tenet of neoliberalism, which alleges an incongruity between the state and the market. Although neoliberalism justifiably sought to reduce the stifling role of the interventionist state and to broaden the role of markets, it is now recognized that the so-called “minimalist state” proposed by neoliberals creates its own problems by further enervating the already acute problems of governance. Indeed, in their eagerness to reduce the scope of the state, policymakers in many places have inadvertently weakened the capacity of the states to do even the most basic things that all states have to do, such as enforce rules or protect property and individual rights. Therefore, if “too much state” resulted in the problem of etatism (that is, excessive regulation, economic mismanagement, and rent-seeking behavior) “too little state” inevitably creates an institutional deficit, spawning poor governance. Therefore, if the various statist and predatory states were part of the problem, representative democratic states can be part of the solution.

**Decentralization and Good Governance**

Concern about the arbitrary powers of central governments have led some to advocate a decentralized federal form of democratic governance. Although the economic and political arguments for decentralization have conspicuously

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During the postwar period, the dominant Keynesian paradigm presumed an active government role in creating desirable levels of growth and employment by managing aggregate demand. Conversely, classical economic liberalism—the nineteenth-century version of contemporary neoliberalism, maintains that economically backward countries can achieve economic development by specializing in producing goods in which they enjoy a “comparative advantage.” Given their belief in the sanctity of markets, the importance of private initiative and incentives, and minimalist government, neoliberals see any reliance on the state as objectionable. For an excellent overview, see Rudiger Dornbusch, *Keys to Prosperity: Free Markets, Sound Money, and a Bit of Luck* (Cambridge, MA: MIT Press, 2000).
converged, there is no consensus as to what precisely “decentralization” should entail in practice. Since, in most cases, decentralized systems of government have three different levels of government (a national level, a regional level, and a local level), in general, decentralization implies devolution of power (which may include the transfer of resources, responsibilities for public services, or decision-making authority) away from the central government to political and administrative jurisdictions below the center. For some, this means the transfer of authority and responsibility for public activity from the central government to “subnational,” or the provincial- or state-level governments. To others, it is devolution to district, municipal, and other local government—including the lowest possible rung of local government. To still others, it is devolution to quasi-independent organizations, and to ancillary local community-based self-governing organizations and NGOs.

The belief that local self-governing institutions operating within the overall framework of a democratic federal arrangement will lead inexorably to political stability and act as a catalyst to economic incentives is not new. In his celebrated *Democracy in America*, Alexis de Tocqueville argued that a vibrant and robust civil society was the foundation of early nineteenth-century America’s democratic success. In Tocqueville’s view, American democracy was sustained by the richness and diversity of its voluntary associations—from religious groupings to business and commercial associations. These independent and active civic associations served as an important bulwark against the negative effects of centralization by keeping in check the dictatorial tendencies of the state. In recent decades, the conspicuous failure of centralized and bureaucratic statism to deliver on either political stability or sustained economic growth, not to mention the egregious human-rights record of many, created disillusionment with all forms of top-down technocratic and managerial governance and calls to roll back the state. It also led to renewed interest in decentralized forms of democratic governance.

Clearly, democracy is strengthened when its formal representative institutions are supplemented by vibrant and participatory civic associations.

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Decentralized governance can help revitalize associational life, long stifled under various forms of centralized and authoritarian rule. It can help give voice to the traditionally excluded and marginalized constituents, enhance civic pride, broaden participation, and improve administrative functioning and accountability. In an important comparative study of the performance of decentralized governments in Bangladesh, the Indian state of Karnataka, Côte d’Ivoire, and Ghana, Crook and Manor note that, in all four cases, decentralization helped to improve public accountability (for example, in Karnataka, it significantly improved the attendance of school teachers), as well as the speed and quality of official response to local issues and needs.77 Similarly, participatory budgeting, undertaken since 1989 by Brazil’s Workers’ Party in municipalities it controlled, allowed poor residents to improve their lives. The experiment which began in Porto Alegre, a city of roughly one million residents, gradually spread throughout the 1990s until it included about one hundred municipalities under the Brazilian Workers’ Party control in 2000. The participatory budgeting, by including poorer neighborhoods (thus reversing the existing trend), allowed residents to see that resources and spending priorities were fairly allocated and to monitor program implementation.78

Moreover, by granting more autonomy to localities and regions, decentralization can strengthen nation building by reducing conflict. Democratic federal arrangements that guarantee the rights of ethnic, religious, regional, and minority groups by granting them power with respect to fundamental concerns such as education, religion, language, taxation, and law and order, can greatly reduce incentives for conflict.79 Similarly, broad local participation and the representation of diverse political, ethnic, religious, and cultural constituencies in public policymaking not only gives national initiatives and policies greater legitimacy, but also enhances program implementation and follow-up. Finally, by bringing government “closer to the people,” decentralization can help make government more efficient and responsive to local conditions and needs.80 A corollary to this is that, by mobilizing citizens to manage and control public programs at the local level, decentralization can help local economies to become more prosperous and equitable.

For example, Ostrom81 and Wade82 argue that decentralization can help resolve collective-action problems in the management of environmental and

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common property resources, while Bardhan notes that, at the local level, ...

...transaction costs are relatively low and the information problems (which cause government failures) less acute... local information can often identify cheaper and more appropriate ways to provide public services, apart from getting a better fit for locally diverse preferences (or getting rid of uniformity constraints in service delivery that a centralized supplier is sometimes compelled to adopt).^{83}

Some studies have highlighted that decentralization can contribute to sound investment decisions. Specifically, decentralization of regulatory responsibilities can help locales to adapt approaches to their conditions and preferences and facilitate the involvement of all stakeholders. Fiscal decentralization can assure local authorities that taxes raised locally will not be appropriated by the central government, giving local authorities incentives to develop their local tax base and target their spending policies (as well as the delivery of public goods) to match the needs and preferences of local residents.^{84}

In fact, in their seminal paper, Weingast, Montinola, and Qian argue that it is the devolution of governmental power and authority from the central to subnational or local governments (the latter including provinces, prefectures, counties, townships, municipalities, and villages) that has been the engine behind China’s rapid economic transformation.^{85} The authors argue that the Chinese style “fiscal federalism” is fundamentally “market-preserving


By devolving regulatory authority from the central to the local governments, the interventionist role of the central government has been limited because it has created political checks on the central authorities. Their theory provides two possible mechanisms for aligning local governments’ interest with promoting markets. One is through interjurisdictional competition under factor and goods mobility to discipline interventionist local governments. That is, decentralized control over the economy by subnational governments within a common market prevents the central government from interfering in markets and reduces the central authorities’ scope for rent-seeking. Another is through linking local government expenditure with the revenue generated to ensure that the local governments face the financial consequences of their decisions. In addition, intergovernmental competition over mobile sources of revenue constrains individual subnational governments. These mechanisms have served to harden budget constraints on enterprises, forcing them to restructure. Finally, some studies have shown that decentralization can permit a degree of institutional competition between centers of authority that can stimulate policy innovation and reduce the risk that governments will expropriate wealth.

However, there is no a priori reason why more decentralized forms of governance will be more democratic, efficient, or provide a close match between citizen preferences and the allocation of public resources. Comparative research increasingly shows that, more often than not, political parties are key actors in decisions on decentralization and that they are most likely to decentralize in a specific situation. O’Neill aptly notes that,

...the party in power believes it cannot hold on to power that is centralized in the national government but believes it has a good chance of winning a substantial portion of decentralized power through subnational elections. Decentralization distributes power at one moment in time to the venues where a party’s political allies are most likely to win in future contests. Thus, decentralization can be seen as an electoral strategy to empower political parties with reasonably long time horizons.86

Indeed, recent research has compellingly argued that there is no necessary relationship between decentralization and improved democratic governance, and that we do not fully understand why some subnational governments are effective in advancing democracy while others are not.87 In multiethnic

and/or divided federations, decentralization can be particularly destabilizing, especially if there is a history of unpredictable cycles of group conflict, the perception that rival groups or communities have disproportionate advantages, and interregional and interethnic groups, including the various nationalities, engage in confrontational mobilizations in their efforts to capture central spoils. Competition in such settings often becomes greatly exacerbated when malcontents in the various administrative and jurisdictional units vicariously mobilize in the pursuit of parochial interests, or when political entrepreneurs politicize group cleavages to exploit the politics of grievance. Experience shows that in such environments, even political movements that start as economic protests can quickly become overtly parochial and chauvinistic—with some groups and communities pursuing policies to “cleanse” pockets of rival communities.

To date, the most comprehensive study on these issues is by Brancati. Using a statistical analysis of thirty democracies from 1985 to 2000, she shows that decentralization may decrease ethnic conflict and secessionism directly by bringing the government closer to the people, including increasing opportunities for citizens to participate in the government. Yet, paradoxically, decentralization may also increase ethnic conflict and secessionism indirectly by encouraging the growth of regional parties. These parties tend to increase conflict and secessionism by reinforcing ethnic and regional identities, producing legislation that favors some groups over others, and by mobilizing groups to engage in ethnic conflict and secessionism. In some cases, political mobilizations under decentralize contexts have the potential to fragment, if not altogether destroy, the state’s cohesion. Even in relatively homogenous societies, excessive mobilizations can quickly overwhelm the national political system. As Huntington noted long ago, instability results when newly mobilized groups, frustrated by the lack of opportunities for socioeconomic mobility, overload fragile and underdeveloped political institutions.

Second, federal power-sharing arrangements that allow groups to have their own schools and religious institutions also magnify the salience of communal identity, making it harder to create cross-cutting ties or build a shared national identity.

Third, lower levels of government are not necessarily “closer to the

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people.” Rather, decentralization can entrench inequalities and transfer social conflicts to the local level. Since much associational life in the developing and transition economies follows inherited patterns rather than voluntary ones—decentralization has the potential to reinforce the traditional relationships of dominance and subordination.

Fourth, decentralization may not always be economically rational or efficient, especially when (a) key institutional and financial pillars are absent from the federal framework or when there is lack of clarity in the respective roles of each tier of government, and (b) if the central government devolves extensive expenditure responsibilities to subnational governments while tightening control over revenue sources. This type of fiscal “centralization by decentralization” increases the political dependency of subnational governments on the center, and weakens their accountability to the citizens who elected them. Moreover, decentralization is generally associated with large and persistent government deficits when subnational governments are simultaneously dependent on transfers and are free to borrow.

There can be a loss of economies of scale as the central government loses control over scarce financial resources, and efficiency losses because of poor local capacity. Furthermore, fiscal decentralization, which involves shifting some responsibilities for expenditures and/or revenues to lower levels of government, can have significant negative implications for macroeconomic stabilization. While in theory the reason for devolving the power to tax to subnational and local governments is because it will encourage fiscal probity, practice generally shows otherwise. Empirical studies by Prud’huiomme and Ter-Minassian show that decentralization often results in subnational fiscal indiscipline, besides worsening fiscal problems at the central level. It seems that, when the political and economic logics of decentralization come into conflict, subnational politicians are hardly prudent—often making important policy decisions (such as spending and delivery of public goods) to gain political advantage. Indeed, some subnational governments have a poor track record on both revenue and expenditures, often out-spending what they collect in revenue. The massive debts accumulated by subnational governments in India, China, Argentina, Brazil, Mexico, and elsewhere have exacerbated national deficits and undermined macroeconomic performance.


Drawing on the experiences of over twenty countries, Ter-Minassian concludes that decentralization not only makes it more difficult to carry out the redistributive and macroeconomic management objectives of fiscal policy, but also that cross-country empirical analysis shows that decentralization is associated with lower growth, higher deficits, and larger governments. Also, as Bardhan points out,

...a decentralized tax system can distort the allocation of mobile factors across localities and hamper the operation of the domestic common market. Many developing countries do not have a constitutional provision akin to that in the United States preventing restraints on interstate commerce; under the circumstances, inter-jurisdictional beggar-thy-neighbor tax competition can easily lead to social inefficiency...  

Since in many developing countries, the economic network of the parallel or “informal” economy operates outside the official or formal economy, decentralization can further entrench these patterns. Moreover, weak administrative and technical capacity at local levels may result in both poor service delivery and haphazard and ineffective program implementation. Since vested interests are more entrenched locally, and corruption and clientelism more prevalent there, decentralization only enables local elites to further consolidate their political and economic control. Moreover, in many poor countries, especially the failing or failed states, the almost complete collapse of the institutional fabric—from the institutions of law and order, to the public infrastructure and basic services—have left behind a political vacuum that cannot be filled by local government. In such a setting, reconstructing a functioning national state is most critical.

Thus, centralization or decentralization by itself is no panacea. Because central and local interests never exist in perfect accord, any attempt to create “local autonomy” along lines drafted in national ministries is bound to fail. Rather, an appropriate balance of centralization and decentralization is essential to the effective and efficient mediation and functioning of government. Such a balance demands good design, sound management, and constant adaptation by all levels of authority. It requires that the national-, subnational-, and local-

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level governments responsibly share policy and supervisory duties—albeit the national authorities must initially create or maintain the “enabling conditions” that allow local units of administration to take on more responsibilities, besides strengthening local institutional capacity to assume their responsibilities. However, local politicians and decision-makers must bear the costs of their decisions and be held accountable for their promises. Finally, there must be a mechanism by which local communities can express their preferences in ways that are binding on local leaders and politicians—so there is a credible incentive for citizens to participate. Thus, there must be a system of accountability that relies on public and transparent information, which enables the community to effectively monitor the performance of the local government and react appropriately to that performance so that politicians and local officials have an incentive to be responsive. The recent effort by the Brazilian government to redesign its federal system to improve incentives for prudent fiscal behavior is instructive. The Brazilian government’s bailout of states in 1997 required states to sign formal debt-restructuring contracts with the federal government, which made the states responsible to bear part of the bailout costs. All new state borrowing was banned until states lowered their debt-to-revenue ratio. Interest penalties were imposed for noncompliance and states could use only constitutionally mandated transfers as collateral for the new state bonds. They were also required to provide down-payments worth 20 percent of a jurisdiction’s outstanding debt stock, and had to agree to a fixed payment schedule based on a jurisdiction’s revenue-mobilization capacity. These actions have greatly improved both the central and state governments’ fiscal positions.

Conclusion

The “dual transition” toward democracy and free market that has swept across much of the world over the past few decades has meant that countries must simultaneously cope with the demands of economic development, political and social integration, and greater public demand for a more equitable distribution of the fruits of development. The ability to respond effectively to these challenges depends much on each country’s institutional endowment. Building and strengthening these institutional endowments is a precondition for good governance, because sustained economic development is impossible without good governance.

In turn, good governance is not only the key to the promotion of human rights and protection of civil liberties, but also good governance is highly correlated with economic development and the potential to deliver significant improvements in living standards. Although a number of countries have improved the quality of their governance, much still needs to be done. As the preceding discussion has argued, although it is the responsibility of countries themselves to improve governance, the developed world has a large stake in promoting good governance, especially in failing and post-conflict states.