

Democracy and economic growth

Democracy

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Does democracy advance, or retard, economic growth? The question has attracted enormous attention from political scientists, sociologists, and economists over the years and has enormous relevance for politics and policymaking in a globalising world. Indeed many democratic regimes have been toppled by coups in the poor countries on grounds that democracy was not serving economic growth.

If democracy impairs economic growth, do we then conclude that it is a luxury to be enjoyed only by countries rich enough to afford it? Dictatorships have often been justified on these grounds—authoritarian leaders commonly use this argument. Idealists weakly counter the authoritarian argument by saying that democracy may be worth the price of economic development since it delivers civic equality, political participation, and civil liberties which are extremely important humanist virtues. Unfortunately the poor—those currently forced to live on one dollar a day, roughly one quarter of the world's population—are not roused by the promise of human virtues. 'Food first' is preferable to 'democracy first.'

Clearly, the question of democracy's relationship to growth is of central importance to the intertwined issues of democratisation and global poverty. Is democracy a development policy? Or, alternatively, is authoritarianism a development policy? Does regime type matter at all?

Is democracy an engine of economic growth? Those in favour argue with the following reasons. First, electoral competition leads to greater social and

economic equality which has been shown to lead to higher growth rates. Second, democratic regimes are associated with lower levels of political conflict (including conflicts based on ethnicity, race, and class), greater political consensus and legitimacy. Third, regular and predictable transfers of power and authority develop a long term planning so conducive to investment. Fourth, property rights are effectively protected since property-owning classes enjoy certain advantages in an open political system. Finally, Democracies are associated with a free media and an openness of government. Hence, they are expected to have a higher level of transparency and accountability and consequently, lower levels of corruption, rent-seeking and other forms of depredation by elites.

Democracy is not without its critics! Authoritarians argue that democracy leads to populist management where required reform takes backseat to spendthrift policies. The result could be a societal pattern of high current consumption and low savings and investment; a substantial increase in the size of government. Additionally, interest group politics could not only lead to greater rentseeking but more domestic conflict and possibly weakening of state power and discipline. Authoritarian rule, by contrast, offers the possibility of a state capable of rising above interest group politics and carrying out aggressive economic reform over the heads of interest groups such as organised labour, and protected lobbies.

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Is the jury still out? Can we settle the debate? Casual empiricism suggests democracy has been gaining globally in the past half century: as the percentage of the world population living under elected governments rose from 31 percent to 58.3 percent. Between 1980 and 2000, 81 countries took significant steps toward democracy. Despite this impressive progress, some 60 countries are still ruled by authoritarian regimes. Moreover, numerous newly democratised nations reverted to authoritarian regimes.

An important point in favour of democracy is that the richer countries are all democratic states. That the oldest democracy—Great Britain—in the world came to rule the world for over two centuries may have something to do with this belief that democracy wins over authoritarian rule. Yet another superpower that took over from Britain—the US—is also a strong and staunch democracy. Strong arguments for democracy!

Economists have for decades now been scrutinising historical data and experience across many epochs and

over many countries to answer such questions. Strictly empirically, democracy is not a causal factor for growth.

Some recent research has shed some new light on the subject. It seems that long-term effects of democracy are positive with respect to economic growth although the short run or immediate effects may not be significantly positive. If democracy matters to growth it is more reasonable to assume that this effect is registered over a period of years, rather than instantaneously. Thus the accumulation of democracy-long spells of democratic institutions leads to better economic performance. It follows from this that old democracies grow faster than young democracies and young democracies grow faster than authoritarian regimes, all other things being equal. Consequently, the faster a transition is made from authoritarianism to strongly founded democracy the better.

The data also shows that growth on average is more stable under democracy than under authoritarian regimes. For those economies that experienced transformation to democracy, economic growth under democracy has been more stable than that under their earlier authoritarian regimes.

Riveres-Batiz of Columbia has shown that democracy may only be a necessary condition for so many good things that can happen to an economy. His result is one that most of us Pakistanis would agree with. His data shows that democracy is a key determinant of growth but only insofar as

it is associated with improved governance. In cases where democracy is not associated with improved governance, it will have very little impact on growth. And in authoritarian countries where the quality of governance is high, growth is likely to also be at high levels. It seems that governance is the determining variable.

The debate has raged long and hard even among economists. Barro, a famous Harvard economist sums it up thus: "in the worst dictatorships, an increase in electoral rights tends to increase growth and investment because the benefit from the limitation on governmental power is the key matter. In places that already have attained a moderate amount of democracy, however, a further increase in electoral rights tends to impair growth and investment. As electoral rights are increased, the dominant effect becomes an intensified concern with social programmes and income redistribution."

A word of caution, we economists do not define democracy naively in the way it has been defined in Pakistan: "one man, one vote to vote for the same feudal lord over and over again." Hayek, a Nobel laureate showed in the 40's that the economic approach to the constitution would lead to a "Constitution of liberty." And such a constitution of liberty is the path to true democracy. More on that some other time.

The constitution is too important a subject to be left to lawyers and army generals alone. Our mess proves it. Time we included some constitutional economists in the process.

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