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Excerpt
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1 What Makes Young Democracies Different?

It is generally accepted that young democracies are particularly likely to experience bad outcomes.

Philip Keefer (2007b)

RECENT YEARS HAVE SEEN A GROWING NUMBER OF ACAdemics and policy-makers express considerable optimism that democracy and economic growth are not only compatible but also mutually reinforcing. Democracy, for example, is alleged to provide investors with secure property rights, fostering growth that in turn strengthens domestic support for fledgling democratic institutions. As an example of this view, leading democracy scholar Larry Diamond (who, among other responsibilities, has served as a governance adviser in Iraq) recently told a group of African leaders that "Africa cannot develop without democracy," while further asserting that the academic literature points "clearly" to "*a causal effect* of democracy on economic growth . . . " (Diamond 2005, italics added).

As a consequence of that supposed causal relationship, he urged those who were gathered to shun any thoughts of adopting authoritarian solutions to their economic problems. Diamond said that the East Asian miracle, for example, "took place in a historic and regional context that is unlikely to be repeated" and that it therefore failed to provide a relevant developmental model for contemporary political leaders, despite continued growth in such countries as China and Singapore

(Diamond 2005). Democracy was not simply one path to development; apparently it was now the *only* path.

Diamond's line of argument stands in sharp contrast to a long tradition of research in political economy making precisely the opposite claim: namely that democracy and democratic institutions, including elections and powerful legislatures, provide political incentives that *undermine* long-run growth (for influential arguments, see Huntington 1968 on developing countries and Olson 1982 on the advanced industrial states). In fact, this older view is now enjoying something of a comeback, thanks to contemporary theoretical research that focuses on the microfoundations of political and economic behavior in developing countries. That work, along with at least some empirical analysis, points to a less optimistic picture of the relationship between democracy and development. As the World Bank has recently concluded, "Unfortunately, democratization does not ensure economic development" (World Bank 2005, 313).

With the jury still out with respect to how young democracies are faring in practice, we begin our examination of these regimes by asking the basic question of what makes them different from older, established governments and thus deserving of "special" academic treatment and policy attention. We focus on five points.

First, many young democracies emerge in the presence of challenging initial conditions such as widespread poverty and inequality, economic dependence on a small range of commodities, and high levels of ethnic fragmentation among other social divisions. Modernization theorists (in a sense going back to Aristotle) would argue that these conditions, such as a poor and uneducated population, make it much more difficult for democracy to take root (Lipset 1959). The countries in our data set, for example, launched their democratic episodes with an average initial percapita income of just over $1,800 in 2006 dollars. Moreover, as Figure 1.1 demonstrates, the distribution of these countries is skewed toward the poorer end of the spectrum, so the median income per capita is $850. On average, the countries that underwent democratization during the

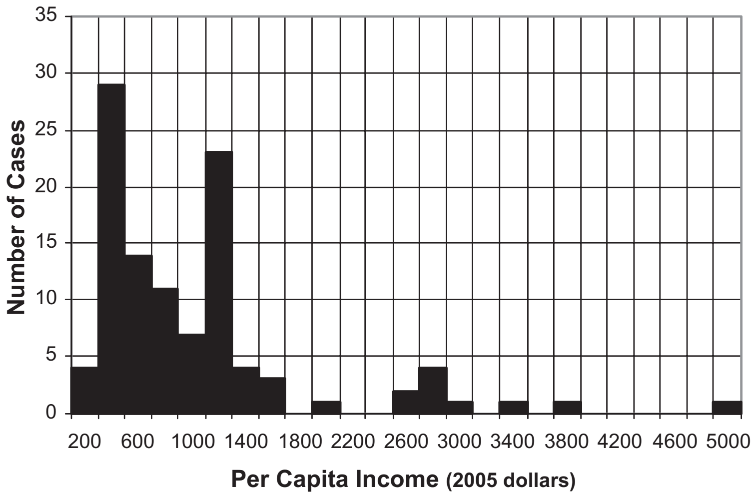

FIGURE 1.1. Per Capita Incomes of New Democracies, 1960–2004. *Source:* WDI, authors' calculations.

period under analysis (1960–2004) have had a poverty rate of just over 20 percent of the population living on less than one dollar per day and over 40 percent living on less than two dollars per day. Given these economic conditions, the first task of a young democracy might be to try and relieve poverty quickly, thus leading to policies that may undermine the foundations for long-run economic growth and possibly democratic consolidation as well.

Second, given these initial conditions, the leaders of young democracies may have difficulty making credible promises to a broad range of constituents, as Keefer has so powerfully argued (Keefer 2007a, 2007b). In deeply divided societies, where asset inequality, ethnic fragmentation, and other divisions (including divisions among elites) have been exploited by previous leaders to advance their own careers, trust may be lacking across social groups. Ironically, efforts by politicians to build such trust may lead them to pursue perverse policies. For example, leaders may rely on clientelistic or patrimonial policies, creating an insider/outsider dichotomy; alternatively, populism may be the order of the day, with economic outcomes like high levels of inflation that end up taxing the poor. The net result is that politicians lack credibility (people do not believe that they can deliver on their promises) and legitimacy (meaning that the government is not viewed as being truly representative). And without credibility and legitimacy, it is difficult if not impossible for the young democracy to consolidate.

Unfortunately for young democracies, credibility takes time to build, as governments engage in repeated transactions with the voting public. But politicians may never have the luxury of time, given the overwhelming economic and political pressures they face to take action. If these actions are not viewed as welfare enhancing, however, the regime will have trouble sustaining itself as a democracy.

Third, and related, young democracies are likely to be characterized by institutional weaknesses, including ineffectual political parties and an absence of effective checks and balances on the chief executive (World Bank 2005). Again, by definition, institutions take time to build and to develop credibility and legitimacy. Central banks need to maintain stable monetary policies over time if they are to establish their inflation-fighting credentials and judicial authorities need time to establish their independence. Parliaments and executives must shape their roles and responsibilities so as to forge a power-sharing arrangement that works. Political parties take time to form and to coalesce around particular themes that aggregate the interests of their constituents, and these parties must also “learn” how to serve democracy by sitting in responsible opposition to the government of the day. Most important, these institutions must interact in such a way as to prevent the concentration of political and economic power: we show that the absence of effective checks and balances is among the most powerful predictors of democratic failure.

Fourth, the political and economic performance of young democratizers is much more volatile as a group than the political and economic performance of older democratic states. There are larger swings in such economic variables as inflation, and there are higher chances of democratic collapse. Separating these volatile states into a separate data set and comparing their experience with that of older democracies might therefore reveal something about their particular pathologies.

Fifth, and finally, the international system weighs more heavily on young democracies than on older democratic states, for better and for worse. These states are more likely to receive foreign aid, which could put specific pressures on their political economy, and they could also be candidates for membership in regional and/or international organizations, requiring them to adopt certain policies if not institutions in order to qualify for accession. As commodity exporters, the international economy could play a more decisive role in shaping their performance, while the rules and regulations of the trade regime could open and close doors to their export sectors, again with significant economic consequences. Most dramatically, democracy may have been imposed on some of these countries by a foreign power (as in Afghanistan and Iraq), and perhaps its maintenance requires the presence of foreign troops.

What these five points suggest is that the fate of young democracies is somehow shaped by the interaction of initial conditions, political institutions, economic performance, and the international community. But we now need to move beyond this "laundry list" in order to make our analysis tractable. Accordingly, in this chapter we begin by asking how the introduction of democracy in the developing world might be expected to influence economic performance from a theoretical standpoint before looking at some empirical evidence on this topic. We concentrate on that particular linkage because, if the academic community agrees on one general proposition with respect to the world's wide array of young democracies, it is probably that their consolidation depends mainly on their economic performance.

As we describe in what follows, there are several distinct institutional pathways that forge a link between a democracy's political arrangements and its economy, influencing in turn its chances for consolidation or collapse.

- First, democracy as a political system may influence the economy directly via the electoral process to the extent that the process induces politicians to favor or adopt policies that please the voting public;
- Second, and related, the linkage between politics and economics may be channeled through political parties, which are supposed to aggregate the interests of voters who prefer particular sets of policies;
- Third, the institutional arrangements that a democracy adopts – for example, whether it is presidential or parliamentary – may have a decisive influence on the types of economic policies that are adopted.

Overall, these three interlocking attributes of a democracy – its electoral system (who gets to vote and which offices are elected), its political parties (how many and which interests are aggregated), and its institutions (what type) – define its constitutional political economy and will help to determine whether governments will be formed and policies implemented that induce agents to engage in productive behavior that furthers democratic consolidation.

We recognize that democratic consolidation requires more than the holding of elections, the founding of political parties, and/or the writing of a constitution. In addition to these institutional factors, many *non*institutional changes are necessary to guarantee the internalization of democratic values and the emergence of what the policy-making community refers to as "good governance," including secure property rights, stable monetary and fiscal policies, and other incentives for long-term investment that promotes sustainable growth. Nonetheless, in considering a nation's constitutional political economy and its evolution during the early years of democracy, we will leave to the side the noninstitutional factors whose influence might be equally if not even more significant for a nation's well-being. For example, *liberal* democracies have many specific attributes – for example, a respect for civil liberties and a free press – that could be of great long-run importance by encouraging, if only indirectly, greater individual creativity and risk-taking.[1] So-called social capital has been often cited as playing a role in boosting both economic performance and governance arrangements, because it provides the trust or cement that enables people to engage in arm's length or anonymous, contractual transactions, which are crucial to the long-run development of a market economy and functioning polity. Democratic governments may also have different *ideas* about economic policy, and those ideas or ideologies could have an independent influence on performance; some countries, for example, may believe that fairness or social justice entails greater income redistribution, whereas others hold it entails greater access to opportunities. These aspects of modern democratic states (i.e., their nongovernmental institutions and their ideas about economic policy) among many others deserve much more attention than we can provide in this brief study.

Voters, Elections, and Economic Policy

If democracies share any fundamental trait, it is the presence of regular, contested elections for public office. In many respects these elections form the core of political life and serve as generators of tremendous civic engagement. But that is not all: the electoral process also reverberates throughout a nation's economy – and perhaps even more so in young democratizers, as opposed to the older industrial states, for good and for ill – via a number of distinctive channels that we trace in this section.

[1] Following the tradition made famous by Drucker in his classic 1939 *End of Economic Man* as well as Friedrich von Hayek and the Austrian School more generally, the Nobel Prize winner Douglass North (1990) has argued that markets function more efficiently in democratic societies due to the personal freedom they allow economic agents. In a similar vein, Amartya Sen has suggested that freer flows of information have prevented famines from occurring under democratic governments (Sen 1994). We note, however, that liberal institutions of this type may be lacking in many young democracies, given that they make take time to develop.

As we will see, for many years scholars have suggested that the competitive, electoral process associated with democracy leads to a number of ill effects, such as budget deficits and redistributive income policies that reduce private investment and growth; thus democracy might not make sense for poor, developing countries that simply could not afford the luxury of dampening growth rates that were already below their optimal paths (Huntington 1968; Rao 1984). However, research has also suggested that political competition could bring a number of economic benefits to democratizers, such as more and better public goods and less corruption. In this section, we first discuss some of the positive impacts of the electoral process on economic policy and performance in young democracies before examining several possible negative effects. Again, if economic performance reflects a government's institutions and policies, we need to relate the two in a deeper way in order to understand why some democracies consolidate while others fail.

To begin with, the holding of contested elections can enhance efficiency and boost growth in several ways.

First, by putting into place a mechanism for accountability – namely the possibility that elected officials will be voted out of office at the end of the term if they perform badly or fail to live up to their promises – elections discipline the temptation to engage in welfare-reducing policies. Whereas an autocrat can arbitrarily expropriate property for his own benefit, the accountability introduced by periodic elections provides a check on this power, leading to stronger property rights, greater economic efficiency, and less uncertainty (North 1990). Bardhan and Yang state the case clearly: "political competition disciplines an incumbent from claiming too much of the economic pie for himself" (Bardhan and Yang 2004, 5), for if he does so, he will be voted out of office.

Second, by generating incentives for groups with opposing policy positions to compromise, elections can ameliorate conflict and promote policy stability. This feature of elections may be particularly important in young democracies in which social or ethnic divisions loom large.

Rodrik (1999, 2000), for example, has elaborated a model in which two groups with divergent policy preferences interact repeatedly to formulate policy. If the groups face uncertainty about which among them will have a superior bargaining position in the future, say through the election of their preferred candidate, they can reach an equilibrium in which they compromise over policy today. By introducing such uncertainty over outcomes through competitive elections, democracy promotes compromise, reducing policy volatility and facilitating better economic performance. Bunce similarly observes that democracy combines "uncertain outcomes with certain procedures," providing the background conditions that inform and motivate economic risk-taking (Bunce 2001, 52).

Third, by introducing competitive pressures into the public sector, democracy provides yet another check on rent-seeking, albeit indirectly, and so improves efficiency. Lake and Baum (2001) lay out a theoretical model in which, in an initial setting, the government is a monopoly provider of public services and as a consequence acts to restrict supply to drive up price in the form of rents or corruption extracted by government officials. With this setting as background, they view the introduction of democracy as a way of rendering the market for public services "contestable," with candidates for political office being potential entrants threatening to undercut the monopoly provider. In short, by introducing competitive pressures into the public sector, democracy has the potential to force the state to supply more and better public services, and even in young democracies it appears that a rapid improvement in the provision and quality of public services often takes place.[2]

[2] This argument, it will be observed, rings of the fiscal federalism literature which argues that federalist systems are efficiency-enhancing because economic agents can vote with their feet and move, forcing local governors to restrain their personal rent-seeking and provide the public services that people actually want. Again, questions may be raised about the benefits of political decentralization in those developing countries where the central government is already too weak to provide many of the public goods that citizens demand.

When Lake and Baum (2001) test their model empirically, they find that public goods provision is not only greater in democracies but also is generally qualitatively superior to that in less democratic countries. In cross sectional regressions, they find that higher levels of democracy are associated with better education, as measured by a host of indicators, including literacy, primary school student/teacher ratios, and the level of enrollment at all grades, and with better health, as measured by life expectancy, mortality, inoculations, and population per physician, as well as access to healthcare and clean water. They also run time series cross sectional regressions and find that an increase in a given country's level of democracy results in a statistically significant and rapid jump in public service provision.

These results are also supported by descriptive statistics included in Papaioannou and Siourounis (2004), indicating that democratization yields rapid increases in life expectancy and schooling. Likewise, Tavares and Wacziarg (2001) find that higher levels of democracy are associated with higher average years of secondary schooling. Keefer (2005) also finds that longer periods of uninterrupted democracy are characterized by higher average secondary school enrollment, further bolstering the claim that democracy is associated with better public service provision. In short, there is some evidence that young democracies do, in fact, respond to voter demands for more public goods. However, Kapstein (2004) finds that the higher the degree of ethnic fragmentation, the fewer the public goods, as measured by infant mortality rates and years of education. Again, to the extent that democracies deliver more public goods, that generalization may mask important differences among young democratic states.

The premise that elections can promote good economic policy and induce the provision of public investment is predicated on a crucial assumption: that politicians are able and willing to make *credible promises* to voters. But as Keefer (2007b) has argued, such credibility is likely to be in short supply, especially in countries that are sharply divided along income, ethnic, or other lines – as is the case in many developing world