Democracy and Economic Growth

Stephan Haggard
Harvard University and The World Bank

(Paper prepared for the U.S. Agency for International Development, Democratic Pluralism Initiative, June 15, 1990.)

The wave of political liberalization washing across the developing world and Eastern Europe has once again raised basic questions about the relationship between democracy and economic growth. The first set of issues is how economic conditions influence politics. Do the level of economic development or growth rates help account for political outcomes, including democracy? Are certain development strategies, economic policies, or conditions more conducive to the consolidation of democratic politics than others?

The second set of questions concerns the relationship between democracy and economic growth. Are stable democratic institutions, the rule of law, and respect for human rights necessary preconditions for growth? Or, as some pessimists have argued, does an expansion of participation and interest group activity inevitably drag down economic performance by increasing demands for consumption and entrenching various inefficiencies? Is there an inevitable trade-off between democracy and development?

These are big questions, and like most big questions, simple answers usually have to admit to numerous exceptions. This paper surveys the terrain, summarizes what is known and not known and raises some questions for debate. The paper is divided into four parts. The first looks at the relationship between economic development and democracy in the long-run, the second looks at the short-run economic constraints on democratic politics.[1] This exercise is repeated with reference to the influence of democracy on growth, looking first at the long-run before examining the capacity of democratic governments to initiate and sustain the economic reforms required to achieve long-term growth.

Several general findings emerge. I state them here baldly, developing the qualifications below.

1. Viewed over the long-run, there is a strong association between the <u>level</u> of economic development and democratic institutions, political rights and civil liberties. It is difficult to define thresholds exactly; this is a source of some hope since it suggests that the relationship is not rigidly deterministic. Below some minimum level of income per capita, however, democracy is rare.

2. Poor economic conditions probably contributed to the wave of democratic transitions we have seen in the last decade. But economic crises have also been associated with the collapse of democratic regimes in the past. Severe economic crises will weaken whatever regime is in power if they exacerbate other political and social cleavages and lead to social polarization.

3. Over the long-run, there is no conclusive evidence that the economic performance of democracies is either better or worse than the economic performance of authoritarian regimes. This suggests that the transition to democracy will not necessarily improve economic performance, and could possibly worsen it, though it is likely to change the distribution of gains from growth. In analyzing these outcomes, however, much depends on political factors not related directly to democracy per se.

4. There is no evidence that the domestic private sector in the developing countries, particularly in manufacturing, is a strong, consistent, or principled supporter either of democracy or the market. Rather, their

support for both has tended to be instrumental, depending on country-specific and policy-specific factors.

5. Some types of authoritarian regimes have been able to undertake economic reforms that would have been highly unlikely under democratic rule. Yet given the difficulty in distinguishing performance between the two types of governments over the long-run, it seems more fruitful to explore the importance of political factors that move beyond the simple distinction between democratic and authoritarian rule. These include the political orientation of the party in power, electoral and interest-group constraints, and the organization of the state itself.

6. Contrary to what is often thought, the transition to a more market-oriented economy demands greater governmental capabilities in a number of areas, as well as the forging of new institutions. A focus on institutional development has the advantage of strengthening the prospects for economic development, while avoiding some of the possible pitfalls from external assistance that will be viewed as unwanted intervention.

I. Economic Development and Democracy: The Long-run

Sociological interpretations of politics have linked successful democratic development with features of the social structure. Only a small step was required to connect the social structure to economic development, producing an economic theory of democracy. Democratic institutions, it was argued, rested on certain "preconditions" such as literacy and mass communication that could only be met at a certain level of development. (Lipset 1959) Higher levels of development were also generally associated with increasing income equality and particularly the emergence of middle classes, which were seen as critical carriers of democratic values. Historically, it was argued, the middle class opposed the status hierarchies associated with traditional forms of rule, sought to check the growth of arbitrary state power through law, and supported ideologies that drew parallels between the benefits of economic and political competition. In the current historical context, it could be argued that middle classes in the developing world are more cosmopolitan and more open to external ideological influences than other strata. As Barrington Moore (1966, 418) argued succinctly for an earlier period of European history, "no bourgeoisie, no democracy."

Table 1 provides some recent evidence on the hypothesis that level of development and democracy are linked; I will call this the Lipset thesis. Following a World Bank classification scheme, 119 countries have been grouped into four categories on the basis of dollar income per capita in 1987: high income, upper middle income, lower middle income, and low income. Two Freedom House scales have been used to measure the extent of political rights and civil liberties in the same year on a scale from 1 to 7, with a score of 1 given to those countries with the most extensive guarantees of these rights and liberties, and a score of 7 to those in which these rights are most restricted.

The table shows the distribution of political scores by income group. There are some interesting exceptions to the Lipset hypothesis. Several low income countries, including India, maintain relatively high scores in terms of political and civil liberties. A few high income countries are also outliers. Kuwait and Saudi Arabia are not surprising in this regard, but Singapore poses a more serious anomaly. Nonetheless, the findings are strongly supportive of the Lipset hypothesis <u>at the extremes of the income scale</u>. Low-income countries tend to have much weaker institutionalization of political rights and civil liberties than high income countries.

The middle-income countries do not conform to Lipset's expectations.

Both subgroups are bi-modally distributed, and the upper-middle income countries have a weaker record of protecting political liberties than the lower-middle income countries. I have run a more comprehensive test on 30 middle-income countries, using data from 1972 through 1986. A bivariate regression of GDP per capita on political rights and civil liberties shows no relationship. On the other hand, it might be expected that there would be greater ambiguity in the middle-income cases, which constitute a "zone of transition" between more and less restrictive polities.

Table 1
Per Capita Income, Political Rights and Civil Liberties, 1987
(Number of Countries/Percentage in Income Group)

	Low Income (<$500)	Lower-Middle Income ($500-2000)	Upper-Middle Income ($2000-6000)	High Income (>$6000)
Political Rights				
1. (Most extensive)	0/0	2/6.1	3/16.7	19/79.2
2.	1/2.4	10/30.3	4/22.2	1/4.2
3.	2/4.8	4/12.1	0/0	0/0
4.	3/7.1	2/6.1	1/5.5	1/4.2
5.	8/19.0	8/24.2	4/22.2	1/4.2
6.	18/42.9	6/18.2	4/22.2	2/8.3
7. (Least extensive)	10/23.8	1/3.0	2/11.1	0/0
Average	5.7	3.6	4.1	1.8
Civil Liberties				
1. (Most extensive)	0/0	1/3.0	2/11.1	15/62.5
2.	0/0	3/9.1	5/27.8	5/20.8
3.	1/2.4	9/27.3	0/0	0/0
4.	2/4.8	6/18.2	2/11.1	0/0
5.	12/28.6	8/24.2	2/11.1	3/12.5
6.	17/40.5	5/15.2	5/27.8	0/0
7. (Least Extensive)	10/23.8	1/3.0	2/11.1	1/4.2
Average	5.1	4.2	4.1	2.0
	N=42	N=33	N=18	N=24

(Source: World Bank, World Development Report 1989 (New York: Oxford University Press, 1989); Raymond Gastil, Freedom in the World: Political Rights and Civil Liberties: 1986-87 (New York: Greenwood, 1987).

These general results are also supported by more sophisticated tests. Cross-national statistical studies have routinely found significant correlations between level of development and democratic rule, even when tested against other hypotheses. (Bollen and Jackman 1985). Conversely, there appear to be close correlations between GNP per capita and coup attempts. (Londregan and Poole 1990)

These findings are sobering, and call into question the optimistic hope that democratic governance can be exported widely. Critics of the Lipset hypothesis point to the exceptions, such as India, to argue that countervailing factors can offset the liabilities associated with low income. Among those that are of relevance to the Indian case are a British colonial heritage and the absolute, rather than relative size of the middle class. Yet the general hypothesis of an association between level of development and democracy is not disproved by a single outlier, even a large one. Viewed over the long run, and for most countries, the achievement of some minimum level of economic development appears to be a necessary if not sufficient condition for democracy.

I draw a somewhat controversial policy implication from this discussion. It is certainly desirable to bring pressure to bear in low-income countries to limit human rights abuses, expand the flow of information, and encourage the development of civic associations. If the Lipset hypothesis is correct, all efforts should be made to accelerate the economic development of low income countries. Nonetheless, those arguing for the transplant of democratic institutions to extremely poor countries, for example, through the organization of "free and fair elections," should be asked why they expect such institutions to take root now if they have not done so in the past.

<u>II. Economic Growth and Democratization: The Short-Run</u>

The Lipset hypothesis fell on hard times beginning in the 1960s as a number of bureaucratic-authoritarian installations occurred in the developing world. The "new authoritarianism" afflicted not only the poorest developing countries, but relatively advanced ones in which the level of industrialization was high. Brazil (1964), Argentina (1966 and 1976), Chile (1973), and Uruguay (1973) were the paradigmatic cases, but reversals of democracy also took place in Korea (1972) and Turkey (1970 and 1980). As we have seen, the middle-income countries present the greatest difficulty for the Lipset hypothesis. There is no evidence that the upper middle-income countries were more democratic than the lower-middle income ones, casting doubt on any simple evolutionary model of the spread of democratic norms.

These cases also raised the question of whether Lipset's cross-sectional observation could be given a dynamic interpretation. Lipset's hypothesis drew the relationship between the <u>level</u> of economic and political development and made no mention of growth <u>rates</u> or other economic variables that might operate on politics in the short-run. As Mancur Olson noted in a provocative essay, rapid growth might itself be politically destabilizing.

The nature of the debate about the relationship between economics and politics shifted from an analysis of long historical patterns toward a better understanding of how short-run economic conditions affected politics. This work focused initially on trying to locate the economic correlates of the breakdown of democratic regimes. Several inter-related arguments came out of this new debate, which was heavily influenced by the dependency thinking then coming out of Latin America. Most of these arguments had a functional form: certain development strategies "demanded" the control of labor and the left. In Peter Evans' pithy statement, "in the context of dependent development, the need for repression is great while the need for democracy is small." (Evans

1979, 35)

Perhaps the most specific argument, one associated with Guillermo O'Donnell (1973), concerned the economic requirements of secondary import substitution. Authoritarian rule was most likely to occur at a critical phase in the process of Third World industrialization. To maintain forward momentum in the production of consumer durables and to generate adequate investible resources to finance these relatively capital-intensive ventures, it was "necessary" to compress wages and concentrate income. This could not be accomplished under democratic auspices. As economic propositions, these claims have been subjected to close scrutiny and wide criticism. (Collier 1979) Nor is it likely that militaries knew about or accepted such arguments, and it is even less likely that they were a primary motivation for political intervention.

A second line of argument looked at the need to attract foreign capital. Authoritarian installations, it was argued, occurred at that stage of development when extensive foreign investment is deemed necessary. Multinationals, banks, and even multilateral institutions such as the IMF and World Bank (Broad 1989) are more likely to invest where labor and the left are controlled.

This is not implausible, and constitutes an important challenge to the assumption that the private sector is necessarily democratic in its political orientation. Business, both foreign and domestic, may be attracted to authoritarian solutions in countries where they see strong threats from labor or the left to their economic viability or basic property rights. The most recent examples have come from the East Asian newly industrializing countries. The business community was actively opposed to more democratic politics in Hong Kong, publicly silent on the issue in Korea, and largely irrelevant to the process in Taiwan. (Haggard 1990, ch. 5)

Yet business may also accept or even spearhead democratic forces where continued authoritarian rule is itself the cause of political instability and uncertainty or where democracy would improve business access to government and reduce unwanted state intervention. This was true in Brazil in the late 1970s and in the Philippines in the early 1980s, when business broke openly with authoritarian governments, and helps explain the growing popularity of the Partido de Accion Nacional (PAN) in northern Mexico, the most economically open part of the country.

A more plausible political-economic explanation of the breakdown of democratic regimes would focus on the contribution of economic crises to broader political and class conflicts. (Wallerstein 1980; Cohen 1987) Military intervention is more likely to occur in response to political crises or stalemates during which contending forces are sharply polarized, including over economic issues such as property rights, the distribution of income, or the appropriate development strategy. Recession and inflation exacerbate such conflicts by providing incentives for groups to mobilize to protect their income shares. Economic conditions, even if they are not the immediate cause of democratic breakdowns, contribute to the level of political conflict and polarization. This pattern is visible in virtually all of the cases of bureaucratic-authoritarian installations cited above: Brazil (1964), Argentina (1966 and 1976); Turkey (1971 and 1980); Chile (1973) and Uruguay (1973).

As the world turned in the 1980s, and more countries became democratic, the academic debate shifted once again to the role economic factors might play in <u>facilitating</u> democratic transitions. Ironically, the poor economic conditions of the 1980s appeared to be a powerful stimulus to democratization. Economic crisis undermined the legitimacy of authoritarian governments, which was often based on economic performance, and compounded the political problems governments had by acting as a spur to protest.

To explore the plausibility of this hypothesis, I have examined trends in per capita private consumption in a number of transitional cases for which comparable data is available. I have distinguished between two periods: a "transition" period, which includes the year of the transition itself and the two previous years, and a "pre-transition" period that reflects a decade-long trend. These comparisons are vulnerable to obvious criticisms. The exercise does not prove that economic factors were dominant, or even central, to the political dynamics of the democratic transitions in question. Moreover, I have not compared the transitional countries with non-transitional ones. There are clearly a number of countries that experienced poor economic performance in the 1980s and did <u>not</u> democratize, particularly in the Middle East and Africa.

Nonetheless, it is striking that periods of democratic transition were periods of relatively poor economic performance when compared with trend. In a number of cases, private consumption declined quite sharply. This is true for five of the six Latin American cases and three of the four Asian cases. The proposition also holds for Hungary, and were data available on economic conditions in Poland in 1989, they would no doubt demonstrate the proposition to hold for that case as well. There is not comparable data for the "pre-transition" period in Portugal and Spain, but the transition periods were characterized by low consumption growth in both countries when compared to the relatively prosperous period of the early 1970s.

Does the observation of a link between economic distress and democratization hold when we examine the transitions in more detail? Economic crisis played a role in undermining authoritarian rule in a number of countries, including Argentina, Bolivia, Peru, Uruguay, the Philippines, Poland, and more recently, Nicaragua. In each case there were also quite distinct political grievances, and the catalyst for change was frequently some political event, such as an election or plebiscite; this was true in the Philippines, Uruguay, Nicaragua and Poland. Nonetheless, economic grievances were clearly important in garnering support for the opposition.

There are several interesting exceptions. In Turkey, the economic reforms implemented by the military from 1981-83 were generally popular, and though the military's handpicked candidate did not win the election in 1983, Turgut Ozal ran on a platform of market-oriented policies that he had overseen for the military during 1981 and 1982. In both Korea and Chile, the transition occurred under relatively good economic performance, and the reaction against the two leaders was largely political. Nonetheless, it is also the case that both Chun and Pinochet had undertaken dramatic economic reforms in the period prior to the transition and that these were politically costly. It is also interesting, however, that there has been a fair degree of continuity in economic policy in these three cases. Incoming civilian governments by and large defended the basic economic orientation of the outgoing military governments.

Table 2
Economic Conditions and Democratic Transitions
Average Annual Changes in Per Capita Private Consumption

Country	Pre-Transition (Years)	Transition (Years)
Argentina	1.6 (1970-80)	-3.6 (1981-83)
Bolivia	1.5 (1970-80)	-6.9 (1980-82)
Brazil	3.7 (1972-82)	0.7 (1983-85)
Chile	1.8 (1976-86)	6.2 (1987-88)a
Peru	2.8 (1970-77)b	-4.2 (1978-80)
Uruguay	0.5 (1972-82)	-4.9 (1983-85)
Korea	4.7 (1972-82)	5.9 (1983-85)
Pakistan	2.3 (1975-85)	0.5 (1986-88)
Philippines	1.8 (1973-83)	-3.8 (1984-86)
Turkey	1.8 (1970-80)	0.9 (1981-83)
Hungary	2.1 (1976-86)	-0.5 (1987-88)a
Poland	-0.4 (1981-86)b	1.9 (1987-88)a
Portugal	na	1.4 (1974-76)
Spain	na	1.8 (1975-77)

(a. Data are unavailable for 1989, the year of the transition itself. b. Data unavailable prior to beginning date cited.
Source: World Bank.)

Recent discussions of democratization often assume a certain inevitability to the process. Such enthusiasm needs tempering. Though economic crisis may have contributed to democratization, there is no reason to believe that the political wheel might not once again turn away from political liberalism. The fact that economic crises in the 1980s have advanced political liberalization cannot be used to dismiss the proposition linking economic difficulties with authoritarian installations. It is probably more accurate to argue that deep and sustained economic crises create problems for <u>whatever</u> sort of government is in power, authoritarian or democratic.

In the hardest-hit countries, the economic crisis of the 1980s has produced severe social strains, including rapid downward mobility for members of the middle class, political polarization, and a general erosion of faith in the capacity of government. Economic difficulties usually have differential effects across different groups, and thus exacerbate class, ethnic and regional cleavages. Data is poor, but the debt crisis has probably widened income inequalities in the heavily indebted countries, and these countries were already among the most unequal in their distribution of income. (Berg and Sachs 1989)

If these cleavages are severe and polarized enough, they can easily overwhelm the consolidation of democratic values and institutions. If new governments are unable to reignite growth, or are lured toward policies that generate new economic crises, anti-democratic social forces on both the left and the right could quite easily expand their influence, and the current trend toward democratization could reverse. The clearest risk of this occurring is in Peru, but the Philippines, Romania and Nicaragua also face daunting problems of democratic consolidation.

The Middle East poses a somewhat different set of problems. The strains associated with rapid economic transformation have been one factor contributing to the emergence of fundamentalist movements. This was true in Iran, and it is now evident in Egypt and Tunisia. These groups have seized the banner of "democratization" to oppose existing authoritarian governments, but their commitment to liberal pluralism as it is understood in the West is uncertain at best. The first test case is likely to be Pakistan, where Benazir Bhutto faces challenges not only from ethnic groups, but from political forces that might be considered restorationist.

It is not my intention to argue that economic factors are the underlying determinants of social conflict or political structure. Some countries are capable of managing quite severe social conflicts while retaining a democratic structure; India, again, provides an example. My objective is simply to underscore that economic conditions can have important political repercussions. This leads quite naturally to the next set of questions this paper seeks to address. How will the trend toward political liberalization in the developing world affect economic policy and performance?

III. Democracy and Development: The Long-Run

The debate about the relationship between democracy and economic growth is an old one, and plausible stories may be told that are diametrically opposed. On the one hand, it has been argued that democratic institutions are conducive to growth, while authoritarian rule undermines it; this is the core of classic, contractarian liberalism. Democracy is associated with the rule of law and the guarantee of individual rights, including in property. Law reduces uncertainty and the costs of transacting and guarantees contract. Individual rights, particularly in property, are crucial for development; without property rights, there is no incentive for risk-taking and capital accumulation and innovation suffer accordingly. More indirectly, democracy is associated with the free flow of information, which also contributes to growth.

A recent AID document introducing the "Democratic Pluralism Initiative" is worth quoting at some length since it is strongly representative of this perspective:

> By and large, economic development and political freedom throughout the world have been mutually reinforcing in modern times. Open societies, through legally guaranteed freedoms of speech, press and association, as well as through free elections and a system governed by the rule of law, allow the unrestricted flow of ideas and the expansion of a private sector that is an important counterweight to state power. Open markets, in turn, promote political diversity by providing employment outside of government, allowing individuals to maintain their livelihood independent of the state." (AID n.d., 1)

Authoritarian rule, by contrast, is associated with arbitrariness, the absence of law, and uncertainty. Tyrants can use their monopoly over the use of force to skew property rights in their favor, undermining any incentive to productive activity, and are more likely to intervene in the economy in various unproductive ways. Authoritarian governments are likely to be corrupt, since they are not subject to scrutiny and criticism. By limiting the flow of information and the scope of public debate, authoritarian governments are more likely to become rigidified.

The opposite view has been summarized neatly by Huntington and Nelson, and has come to be known as the "incompatibility hypothesis" (1976, 26): "The liberal model of development avoided the problem of choice by claiming that all desirable values could be maximized. But it has turned out not to be a realistic or relevant choice for most modernizing societies." Democracies permit the flourishing of interest groups, which almost by definition are concerned not with public welfare but with seizing the largest share of the social pie for themselves. (Olson 1982) Democracies generate demands on the state, and on total resources, which are likely to be met by expanding consumption at the expense of investment; democracies are myopic. Finally, democracy also generates its own uncertainties. It is true that democracy is associated with the rule of law, but laws can also be changed as governments change; indeed, uncertainty is a central feature of democratic governance.

Conversely, authoritarian rule has its advantages. Authoritarian governments place restraints on self-interested actions through rules backed by sanctions; the collective action dilemmas that are so characteristic of development can be resolved by command. Authoritarian rule gives political elites greater independence from distributionist pressures and increases their ability to extract resources, provide public goods, and impose the short-term costs associated with efficient economic adjustment. (Haggard and Moon 1990)

As might be expected where such conflicting views exist, the evidence is contradictory and inconclusive. Gerald Scully (1988) has offered one of the more comprehensive and direct statistical tests of the two competing propositions, using Gastil's Freedom House indicators and data on 115 market economies over the period from 1960 to 1980. Scully finds evidence of a large growth differential, 2.53 percent per annum vs. 1.41 percent, in favor of politically open societies. Yet there are methodological problems with Scully's analysis, including the omission of non-market economies, a failure to distinguish adequately between political and economic liberties, and the construction of indicators in a way that reduces the weight of the rapidly growing middle-income countries in the sample, many of which are authoritarian. Other studies support Scully's conclusions, however. Barro (1989) and Kormendi and Meguire (1985) find that a political rights variable is positively associated with growth in large cross-sectional analyses, and Dick (1974) and Kohli (1986) both raise doubts about the claim that authoritarianism promotes growth.

In another large cross-national comparison, however, Erich Weede (1983) finds no relationship between democracy and economic growth in the developing world taken as a whole. There is a relationship in those countries in which state intervention in the economy is high, though; in these economies democracy retards growth. Jackman (1976) also finds no systematic evidence that military regimes are either successful modernizers, nor that they retard economic development. Finally, a number of cross-national studies have found evidence that authoritarianism does in fact promote economic growth. (Adelman and Morris 1967; Huntington and Dominguez 1975; Marsh 1979)

Methodological criticisms of these studies are numerous. Even where there are results, the associations are usually weak. The methods are generally quite crude. With a few exceptions, most of the work in this area to date has been done by political scientists, and as a result it does not rest on plausible economic models of the growth process. The appropriate methodology is to introduce political variables into existing economic models, thus establishing adequate controls for the other determinants of the outcome in question, whether growth, inflation or investment. (Scully 1988; Barro 1989; Haggard, Sharif and Webb 1990)

Yet there is another, more compelling reason why these studies yield poor results: they are conceptually flawed. The distinction between authoritarian and democratic systems, and even more nuanced measures of democracy or pluralism, are not necessarily the political variables that are most relevant for explaining economic performance. We can therefore expect quite disparate performances among governments with similar ratings on a democracy-authoritarian scale.

It is therefore possible that the transition to democracy will improve economic performance, but this is by no means a foregone conclusion. Three examples might be cited. Haggard and Kaufman (1989a) have noted that a distinction can be drawn between "strong" and "weak" authoritarian regimes. The former have organizational characteristics that are conducive to rapid growth, such as centralized decision-making and meritocratic bureaucracies. Korea, Taiwan, and Singapore are examples. While none of these governments were by any means laisser-faire, they were more oriented toward the market, and toward exports in particular, than most other developing countries. Moreover, they achieved this market orientation under authoritarian auspices. (Haggard 1990) Zaire and Haiti, by contrast, are examples of "weak" authoritarian regimes that are penetrated by networks of patron-client relations and corruption and unable to pursue any coherent policy.

A second example might be drawn from Africa. If democratization there is accompanied by an increase in violence, perhaps associated with new ethnic tensions, it could quite easily lead to a worsening of economic performance. (Wheeler 1984) On the other hand, if democracies do succeed in avoiding these pitfalls and acting as a check on arbitrary decision-making and extensive state intervention, then economic performance could improve.

In Latin America, finally, a number of authors have noted that populist governments pass through a predictable policy cycle. (Dornbusch and Edwards 1989; Sachs 1989) Newly elected populist governments, often responding to past periods of wage compression or limitations on labor activity, seek to redistribute income to the urban popular sector through expansionist fiscal and monetary policies and generous wage contracts. These policies prove unsustainable, leading to large fiscal and balance of payments deficits, inflation, and eventually a painful stabilization. The terms of debate on economic policy have fundamentally changed in Latin America in the last ten years in the direction of greater economic liberalism, but it is premature to dismiss populism as a thing of the past; witness the popularity of Cardenas in Mexico, Lula in Brazil, and Alan Garcia in Peru. The election of Menem in Argentina, Andres Perez in Venezuela, and Manley in Jamaica did not result in a turn toward populism, but all three were elected in part because of their identification with policies responsive to the plight of the "little guy." Vargas Llosa's campaign in Peru, by contrast, was severely damaged by his promise to launch difficult adjustment measures if elected. If democracy means a return of populist political forces and the political polarization that frequently accompanied them, then economic performance will suffer.

The broader analytic point is that a number of political variables are important for explaining growth, and these can cut across the authoritarian-democratic distinction. Among them are the orientation of the party in power, the stability of the government, and the degree of state intervention in the economy. I now turn to an analysis of how some of these factors might affect the prospects for economic reform in new democracies.

IV. Democracy and Economic Performance in the Short-Run: The Politics of Economic Reform

In seeking to promote growth, governments face two, somewhat different policy challenges. The first is to achieve or maintain macroeconomic stability. Where inflation is already high, this means painful stabilization measures: reducing expenditures, raising taxes, and controlling the growth of the money supply and wages. Short-term balance of payments problems also demand exchange rate adjustments. The long-term challenge is to liberalize the economy. Liberalizing measures include reducing trade barriers, reforming pricing policy, reducing intervention in financial markets and reforming or privatizing the state-owned enterprise sector.

At the broadest level, these reforms face two types of political barriers; I will call them the coalitional problem and the time-inconsistency problem. The first arises as the result of the balance between negatively and positively affected groups in the reform process. Though economic theory tells us that these reforms are superior for society as a whole, they can have substantial costs for some groups, Public attention is captured by "IMF riots" that accompany the lifting of food subsidies, but powerful groups within the private sector are likely to be equally vociferous opponents of market-oriented reform; such opposition is by no means limited to the government itself. Among those negatively affected by structural adjustment are traders and commercial interests with privileged access to foreign exchange and imports, consumers of subsidized inputs from state-owned enterprises, recipients of subsidies, and both labor and management in protected firms in the import-substituting sector. In most developing countries, the non-traded goods sector benefits from an overvalued exchange rate in comparison with the traded-goods sector. Moreover, these groups are likely to be relatively powerful compared to the beneficiaries of reform efforts. They are, for the most part, located in the urban areas and benefit from greater opportunities for organization. Economic reform must therefore be treated as a problem of coalition management; successful reform means compensating or finessing losers, while building a new base of support among the gainers. (Waterbury 1989; Nelson 1989, 1990) Some of the cleavages that are likely to emerge in this process are summarized in Figure 1.

Figure 1
Policy Coalitions and Cleavages

Policy	Favored Interests	Neutral or Uncertain	Threatened Interests
<u>I. Short-term Measures</u>			
A. Devaluation	Traded goods sector	Workers, peasants (depends on traded goods/ consumption)	Non-traded goods sector
	Holders of foreign assets		Holders of foreign-denominated debt
B. Cutting expenditure	Foreign creditors		Public sector workers Suppliers Recipients of subsidies, services and transfers
C. Increased revenues	Depends on incidence of taxes		
D. Monetary contraction	Liquid-asset holders Non-indexed groups Traded goods sector (fixed ex. rate) Foreign and domestic creditors		Debtors Non-traded goods sector (fixed ex. rates)

Figure 1, continued

Policy	Favored Interests	Neutral or Uncertain	Threatened Interests
<u>II. Structural Adjustment</u>			
A. Trade liberalization	Importers Exporters Consumers Purchasers of protected capital and intermediate goods		Import-substituting industry, local and foreign Labor in ISI sectors Agriculture where protected
B. Domestic price reform	Depends on whether group is net seller or purchaser of liberalized good		
C. Financial market reform	Savers Borrowers w/out access to subsidized credit Foreign banks and investors	Banks (depends on portfolio structure)	Informal financial sector (kerb market) Borrowers with access to subsidized credit
D. Privatization of state-owned enterprises	Large domestic and foreign investors Consumers of SOE goods where monopolized Competitive private-sector firms		Workers and management of SOEs Privileged suppliers Consumers of SOE goods where subsidized

The second difficulty arises out of the time horizon of the politician. The benefits of reforms may take some time to unfold, but the time-horizon of the politician is sometimes quite short as a result of electoral or other political constraints.

These two problems suggest the following hypothesis: reform is most likely when political elites are temporarily or permanently freed from political constraints. This might happen in several ways. The first is through the exercise of dictatorial powers. The most heated and long-standing debate in the literature on the politics of stabilization and structural adjustment concerns the relative capacity of authoritarian and democratic governments for instituting reforms. (Skidmore 1977; Sheahan 1980; Remmer 1986; Haggard, 1986; Haggard and Kaufman 1989a) Clearly, authoritarian governments have been able to launch quite extensive adjustment initiatives in some cases; Chile, Korea, Turkey, Ghana provide recent examples, and Mexico, with its corporatist organization of interests might also be added to the list.

Yet as we have seen above, there does not appear to be any convincing link between regime type and growth over the long-run. This apparent contradiction can be reconciled by giving greater attention to the broader political setting in which conflicts over economic policy are played out. In settings where partisan alignments are severely polarized or fragmented, regime type *has* made a difference, and incoming military governments have "solved" economic policy problems that democratic governments could not.

A recent collective research project on the politics of adjustment finds, however, that the willingness of governments to initiate new economic policies is more closely associated with *changes* in government than it is with the type of regime. (Nelson 1990) Governments facing upcoming electoral challenges, not surprisingly, have been reluctant to impose unpopular programs. Interestingly, this is found to be true of both democratic and authoritarian governments. As military governments seek to negotiate an exit from government, political constraints resurface powerfully. This was true in Argentina and Brazil during the transition period, and has proven a major constraint on economic reform in Nigeria.

Incoming governments, by contrast, can capitalize on honeymoon periods, particularly where the opposition is weak and its policies discredited. Dramatic stabilization efforts were launched by Paz Estenssoro in Bolivia, the new Solidarity government in Poland, by Collor in Brazil and by Menem in Argentina. Where economic conditions have been deteriorating and the ruling party's policies have been discredited, democracies have launched quite substantial structural reforms as well. Examples include Colombia in the late 1960s, Sri Lanka in the late 1970s, Costa Rica and Jamaica in the early 1980s, and at least in some regards, by Aquino in the Philippines, including tax reform, trade liberalization, and the reform of agricultural pricing policy.

If politicians are politically positioned to launch reform efforts, there remains the problem of their technical ability to do so. Reforms vary in their organizational intensity and the nature of the skills required to implement them. Dismantling some interventions is simply a matter of issuing cease and desist orders; of getting bureaucracies to stop doing what they have done in the past. Where bureaucracies are centered entirely around interventions in the market that are no longer deemed necessary, such as marketing boards or boards of investment that dispense licenses, the bureaucracy itself might simply be dismantled.

Yet it is frequently overlooked that many economic reforms demand administrative and technical capabilities that are in short-supply in poor countries: adequate education among middle- and low-level personnel; specialized training for higher-level and technical staff; and information processing, gathering and communication capabilities. Miles Kahler (1990) has called this the "orthodox paradox: liberalization itself demands a strengthening of the state's capabilities and an ability to reconcile conflict claims within the bureaucracy itself.

Examples abound. The control of public expenditure requires the establishment of multi-year public investment programs, the capacity to monitor projects once launched, and institutional mechanisms to make expenditures transparent and permit a smooth reconciliation of spending and revenue decisions. Trade reform is often seen simply as a process of removing restrictions, but successful export promotion involves more extensive interventions, such as drawback and exemption schemes for exporters, the provision of overseas market information, and the management of export-processing zones. Other reforms demand the establishment of modern economic institutions that are frequently underdeveloped. For example, successful privatization in Eastern Europe and elsewhere will rest on the ability to develop capital markets on which shares can easily be traded, and the regulatory apparatus to oversee them.

There is a useful policy lesson to be drawn from this discussion. Some political parameters, such as the timing of elections and the nature of the party system are not manipulable, but knowledge of their consequences can be useful in timing assistance or the launching of initiatives. The structure of interest groups might appear to be a relatively fixed component of the political landscape, but this is not true. It might be possible for outside donors to assist in the organization of those groups who would benefit from reform. Yet it should be understood that this is a risky business. As the

Peruvian election campaign shows once again, reformers can be delegitimated by their connections with outside agents. Moreover, from the perspective of economic reform, more powerful interest associations may or may not be a good thing; it all depends on the orientation and interests of the groups in question. Strengthening the institutional capabilities of governments does seem relatively risk-free, though, and for the low-income countries is likely to make an important contribution to economic reform.

V. Conclusion

A discussion of the full range of political factors that might impinge on economic policy once democracy is established is far beyond the scope of this paper. Given the relatively recent arrival of democratic institutions in the developing world, there is much we do not know about how new political structures will work and what their effects on economic reform will be. For example, do parliamentary systems have certain advantages over presidential ones? How will legislative-executive relations affect economic policy-making? Just as partisan differences result in different policy outcomes in the advanced industrial states, so we can expect that different governments in the developing world will also develop different policies. How will the party structure affect the consolidation of economic reforms? Are different internal bureaucratic organizations more conducive to sound policy, for example, the combination of budgeting, finance, and planning functions?

For the purpose of assisting new democracies, these questions are the most important ones; unfortunately, we don't now have many answers to these questions.

It is clear, however, that there has been a substantial amount of painful social learning over the last decade. When the debt crisis broke in 1982, it was seen mainly as a short-term problem that could be solved through a combination of relatively quick adjustment measures, economic recovery in the advanced industrial states, and a rescheduling of external obligations. By the middle of the 1980s, the view of the crisis had changed. While the debt overhand remains a critical problem today, there is a broader recognition that many problems are the result of development models which date to the 1930s and 1940s in some Latin American countries, and to independence in Africa and South Asia. In seeking to assist the positive changes that are taking place, it is important to keep in mind that fundamental reorientations in development strategy cannot be expected to take place swiftly.

References.

Adelman, Irma and Cynthia Taft Morris. 1967. Society, Politics, and Economic Development. Baltimore: Johns Hopkins University Press.

Agency for International Development, Asia and Near East Bureau. n.d. "Democratic Pluralism Initiative (DPI): Open Markets-Open Societies." Processed.

Barro, Robert. 1989. "A Cross Country Study of Growth, Saving and Government," National Bureau of Economic Research Working Paper No. 2855.

Bollen, Kenneth A. and Robert Jackman. 1985. "Economic and Non-Economic Determinants of Political Democracy in the 1960s," Research in Political Sociology. Greenwich, CT: JAI Press.

Broad, Robin. 1988. Unequal Alliance: The IMF, the World Bank, and the Philippines. Berkeley: University of California.

Cohen, Youseff. 1987. "Democracy from Above: The Political Origins of Dictatorship in Brazil," World Politics 40, 30-54.

Collier, David, ed. 1979. The New Authoritarianism in Latin America. Princeton: Princeton University Press.

Dick, G. W. 1974. "Authoritarian vs. Non-Authoritarian Approaches to Economic Development." Journal of Political Economy. 82: 817-827.

Dornbusch, Rudiger and Sebastian Edwards. 1989. "The Macroeconomics of Populism in Latin America." World Bank, PRE Working Paper.

Evans, Peter. 1979. Dependent Development: The Alliance of Multinational, State, and Foreign Capital in Brazil. Princeton: Princeton University Press.

Haggard, Stephan. 1986. "The Politics of Stabilization and Structural Adjustment." in Miles Kahler, ed., The Politics of International Debt. Ithaca: Cornell University Press.

____. 1990. Pathways from the Periphery: The Politics of Growth in the Newly Industrializing Countries. Ithaca: Cornell University Press.

____ and Robert Kaufman. 1989a. "The Politics of Stabilization and Structural Adjustment," in Jeffrey Sachs, ed., Developing Country Debt and Economic Performance, v. 1: The International Financial System. Chicago: University of Chicago Press.

____ and Robert Kaufman. 1989b. "Economic Adjustment in New Democracies," in Joan Nelson, ed., Fragile Coalitions: The Politics of Economic Adjustment. New Brunswick: Transaction Books.

____ and Robert Kaufman. 1990. "The Political Economy of Inflation and Stabilization in Middle-Income Countries," World Bank PRE Working Paper, June.

____ and Chung-in Moon. 1990. "Institutions and Economic Growth: Theory and a Korean Case Study." World Politics. 42, 2.

____, Karim Sharif and Steven Webb. 1990. "Political Determinants of Inflation." World Bank, processed.

Huntington, Samuel and Jorge Dominguez. 1975. "Political Development," in Fred Greenstein and Nelson Polsby, eds., Handbook of Political Science, v. 3. Macropolitical Theory. Reading, Mass.: Addison Wesley.

Huntington, Samuel and Joan Nelson. 1976. No Easy Choice: Political Participation in Developing Countries Cambridge: Harvard University Press.

Jackman, Robert W. 1976. "Politicians in Uniform: Military Governments and Social Change in the Third World." American Political Science Review.

Kahler, Miles. 1990. "Orthodoxy and its Alternatives," in Joan Nelson, ed., Economic Crisis and Policy Choice: The Politics of Adjustment in the Third World. Princeton: Princeton University Press.

Kohli, Atul. 1986. "Democracy and Development," in John Lewis and Valeriana Kallab, eds., Development Strategies Reconsidered. New Brunswick: Transaction Books.

Kormendi, R.C. and P.G. Meguire. 1985. "Macroeconomic Determinants of Growth: Cross-Country Evidence." Journal of Monetary Economics.

Lipset, Seymour Martin. 1959. "Some Social Requisites of Democracy: Economic Development and Political Legitimacy." American Political Science Review, 53, 69-105.

Londregan, John and Kenneth Poole, 1990.

Marsh, Robert M. 1979. "Does Democracy Hinder Economic Development in the Late-comer Develping Nations?" Comparative Social Research, 2: 215-248.

Moore, Barrington. 1966. Social Origins of Dictatorship and Democracy. Boston: Beacon Press.

Nelson, Joan. 1989. Fragile Coalitions: The Politics of Economic Adjustment. New Brunswick: Transaction Books.

____, ed. 1990. Economic Crisis and Policy Choice: The Politics of Adjustment in the Third World. Princeton: Princeton University Press.

O'Donnell, Guillermo. 1973. Modernizationa and Bureaucratic Authoritarianism: Studies in South American Politics. Berkeley: Institute for International Studies, University of California.

Olson, Mancur. 1982. The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities. New Haven: Yale University Press.

Remmer, Karen. 1986. "The Politics of Stabilization: IMF Standby Programs in Latin America, 1954-1984," Comparative Politics 19: 1-25.

Sachs, Jeffrey. 1989. "Social Conflict and Populist Policies in Latin America." NBER Working Paper No. 2897, March.

Scully, Gerald W. 1988. "The Institutional Framework and Economic Development." Journal of Political Economy. 96, 652-662.

Sheahan, John. "Market-Oriented Economic Policies and Political Repression in Latin America," Economic Development and Cultural Change. 28: 267-291.

Skidmore, Thomas. 1977. "The Politics of Economic Stabilization in Postwar Latin America," in James M. Malloy, ed., Authoritarianism and Corporatism in Latin America. Pittsburgh: Pittsburgh University Press.

Wallerstein, Michael. 1980. "The Collapse of Democracy in Brazil: Its Economic Determinants." Latin American Research Review. 15, 3-40.

Weede, Erich. 1983. "The Impact of Democracy on Economic Growth: Some Evidence from Cross-National Analysis." Kyklos 36, 1: 21-39.

Wheeler, David. 1984. "Sources of Stagnation in Sub-Saharan Africa." World Development. 12, 1: 1-23.

Footnote

1. When referring to "democracy" and "democratization," I will limit myself to the political rules governing national politics. Democratic regimes are those in which free speech and organization are guaranteed, leaders are chosen in competitive elections, and governments are not systematically subject to the veto or control of non-elected individuals or institutions. Increasingly sophisticated scales have been devised for the measurement of political liberalization and democracy. Though these are used in the paper, I generally limit myself to the dichotomous distinction between democratic and non-democratic governments. My emphasis is therefore subtly different than a focus on the relationship between human rights or participation and economic development, and does not examine the effects of the extension of democratic norms and principles beyond the central government, for example to the workplace.

I also limit myself largely to a discussion of economic growth seen as an expansion of national output. I do not address the important question of equity or the ability of the government to meet other economic targets, such as managing inflation, except insofar as they are seen as contributing to economic growth.