Growth and Poverty Reduction Does Political Regime Matter?

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1. INTRODUCTION

Political regimes can take different forms, ranging from democracy to authoritarianism to totalitarianism. These regimes differ in terms of the freedom they offer for the individuals to participate in the political process, the role free and fair elections play in the selection of the ruler(s), and the system of checks and balances in the exercise of power by the ruler(s). Political regimes help define and delimit political liberties an individual enjoys in a society. While these political liberties are important by themselves and have a significant bearing on individual welfare, they are distinct from economic freedom. The quintessential elements of economic freedom are autonomy of personal choice, freedom to engage in voluntary exchange, the right to compete in the economy, and the security of person and property. When an economy has in place institutions and polices that safeguard economic freedom, it helps to create an enabling environment that permits individuals to cooperate and specialize according to one's comparative advantage. If property rights are secure, individuals are protected from arbitrary government interventions, and special interest groups are denied special favors: they help reduce costs of economic transactions, ensure economic efficiency, enhance economic growth, and benefit the less powerful segment of the society. The main indicators of economic freedom commonly include: size of the government; sound money and stability of price; freedom to trade with foreigners; absence of over-regulation of markets, including the labor market; and security of property rights, rule of law, and protection from government malfeasance.

Economic freedom is, however, closely related to a set of important liberties, what Zakaria (1997) calls “constitutional liberalism” in the form of “the rule of law, a separation of powers, and the protection of basic liberties.” As Zakaria argues, a democracy does not need to be liberal, although democracies developed side by side and along with constitutional liberalism in the West. Similarly, an autocracy does not need to be illiberal, as has been the case with the miracle economies of East Asia[1] when their economies took off.

This essay explores the relationship between political regime and critical economic outcomes such as economic growth and poverty reduction. This relationship entails important qualitative social and historical dimensions that are not amenable to usual quantitative investigation undertaken by economists. Therefore, to explore these issues, we take a broader comparative perspective that juxtaposes the experiences of South Asia against those of more successful East Asia. It is hoped that such a comparative review would provide important insights into the policies and institutions that were critical to the socio-economic transformation of the successful economies.

The organization of the paper is as follows. Section 2 makes a brief review of the economic performance of developing Asian economies over the last four decades. As these economies have varied significantly in terms of economic outcomes as well as their political complexions, a simple juxtaposition of the two would suggest a link between political regimes and economic outcomes. Given this apparent association between political regimes and economic outcomes, this section argues that the superior economic performance (in terms of economic growth and poverty reduction) of the

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[1] Discussion in this paper has focused largely on the market-based miracle economies. Although People’s Republic of China (PRC) has been a miracle performer for the last 25 years or so, it has been a transitional economy whose economic problems and challenges are in many ways unique and are unlikely to apply to other developing economies.

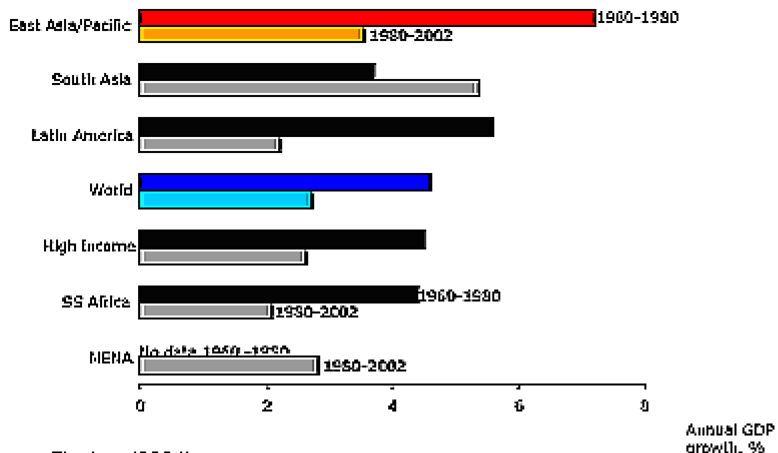
authoritarian or semi-authoritarian East Asian economies, compared to their democratic counterparts, can be attributed to their underlying differences in the process of policy making, in the nature of the bureaucracy, and in the type of economic governance. Sections 3 through 5 provide further elaboration on this. The paper ends in Section 6, which offers some concluding remarks.

2. POLITICAL REGIMES AND ECONOMIC OUTCOMES

In the past four decades, the performance of East Asian economies has been far superior to other regions of the developing world (Figure 1). Compared to the other countries of the world, the average growth rate of East Asian economies has been almost 2-percentage points higher than the growth rate among other countries. Given the magic of compounding, this has helped these countries to advance rapidly up the ladders of economic development and achieve spectacular improvements in the quality of life.

Some economies such as Hong Kong, China; Republic of Korea (henceforth Korea); Singapore; and Taipei, China— which are now labeled as the newly industrialized economies (NIEs) of Asia—have telescoped into a single generation a process of socioeconomic development that took the advanced economies of Western Europe centuries to achieve. The dramatic improvement in the quality of life that accompanied this miraculous economic transformation has virtually abolished extreme poverty in these societies.

Figure 1. East Asian growth Rates in Global Perspective 1960-2002



Source: Fischer (2004)

A number of Southeast Asian economies, such as Indonesia, Malaysia, and Thailand have also made impressive strides in economic development that have resulted in a rapid reduction in poverty and brisk social development. The achievements of East Asian economies, in terms of economic growth and poverty reduction, are indicated in Tables 1 and 2, respectively. Table 1 shows the growth rates of individual countries whereas Table 2 indicates the trend of poverty reduction across the region.

Table 1: Growth Rates of East Asian Economies , 1960-2002

(real GDP growth rate, annual percentage)

	1960-2002	1960-1980	1980-2002
Indonesia	5.5	6.0	5.1
Malaysia	6.6	7.2	6.1
Thailand	6.7*	7.5**	5.9
Hong Kong, China	7.2	9.5	5.1
Taipei, China	7.8	9.0	6.6

Korea, Rep. of	7.5	7.8	7.1
Singapore	8.0	9.3	6.8

Notes: * refers to the period 1961-2002; **refers to the period 1961-1980
Sources: Fischer (2004) and National Statistics of Taiwan (June 2004)

Even though the 1997–98 financial crisis undid some of the economic advances these economies had made, their achievements in improving the quality of life of the general populace remain largely unscathed. Growth has by and large resumed in all the crisis economies, but to a lesser extent in Indonesia. The case of Indonesia is somewhat complex. It has had to cope not only with the rough and tumble of the financial crisis, but also with the difficult process of transition from a stable authoritarian regime to a raucous democracy, intertwined with insurgencies and civil war. While jolted by the crisis, the socioeconomic transformation of these economies—henceforth collectively referred to as the miracle economies—that has unfolded over the last 40 years has been singularly impressive, and has understandably attracted wide academic and policy interest.

Table 2: Headcount Indices of Poverty

(percentage of people living below $1.08 per day at 1993 PPP)

	1981	1984	1987	1990	1993	1996	1999	2001
East Asia	57.7	38.9	28.0	29.6	24.9	16.6	15.7	14.9
People's Republic of China	63.8	41.0	28.5	33.0	28.4	17.4	17.8	16.6
East Asia excluding People's Republic of China	42.0	33.5	27.0	21.1	16.7	14.7	11.0	10.8
Eastern Europe and Central Asia	0.7	0.5	0.4	0.5	3.7	4.3	6.3	3.6
Latin America and Caribbean	9.7	11.8	10.9	11.3	11.3	10.7	10.5	9.5
Middle East and North Africa	5.1	3.8	3.2	2.3	1.6	2.0	2.6	2.4
South Asia	51.5	46.8	45.0	41.3	40.1	36.6	32.2	31.3
India	54.4	49.8	46.3	42.1	42.3	42.2	35.3	34.7
South Asia excluding India	42.2	37.0	41.0	38.7	33.1	19.7	22.9	21.0
Sub-Saharan Africa	41.6	46.3	46.8	44.6	44.1	45.6	45.7	46.4
Total	**40.4**	**32.8**	**28.4**	**27.9**	**26.3**	**22.8**	**21.8**	**21.1**

Source: Chen and Ravallion (2004).

When one juxtaposes the performance of the miracle economies and their enormous strides in poverty reduction against that of South Asia, one is struck by the stark contrast. Despite progress in recent decades, South Asia remains the bastion of poverty in both Asia and the world. About three in ten Indians still fall below the national poverty line, and almost one in three would be classified as poor based on the US$1 per day international poverty line. The incidence of poverty in Bangladesh and Nepal exceeds that in India. This sharp contrast between East Asia and South Asia is also apparent when considering other aspects of the quality of life, not just income poverty.

The one characteristic common to the political regimes of the miracle economies was their authoritarian nature. As Varshney (1999) noted, Singapore had been authoritarian since its founding in the mid-1960s, and Korea and Taipei, China conquered poverty during the mid-1950s to the mid-1980s under dictatorial regimes. Indonesia made significant strides in poverty reduction during 1971–91, when it was still under the dictatorial rule of Suharto. Similarly, Malaysia virtually eliminated poverty under a regime that was less than fully democratic.[2] When this experience is juxtaposed against that of India, it appears that democracies have been slow in grappling with poverty as compared with the authoritarian regimes in the miracle economies. This has led many to conclude that authoritarianism is conducive to rapid economic growth and social transformation—or alternatively, authoritarianism is favorable to good economic policies and institutions that promote economic development and poverty reduction.

How does the above claim stand up to facts? In developing Asia, one finds countries that embraced authoritarianism—for example, Pakistan and the Philippines—for a large part of the last four decades did not yet achieve an economic miracle. On a global scale, some of the worst economic performers were the authoritarian regimes of Africa and Latin America. However, the best economic performers were the authoritarian or semi-authoritarian regimes of East Asia.[3] Econometric studies that control for the other influences on growth find no robust correlation between economic growth and political regime. A notable study by Barro (1996) shows that there is no significant relationship between democracy, which ensures political freedom, and economic growth. However, he finds a strong relationship between economic freedom and growth.

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[2] In his celebrated accounts of democracy, Dahl (1971, 1989) lays out two basic criteria of democracy: contest (the freedom to contest the rulers) and participation (of diverse political groups in the process of determining the rulers). The first criterion pertains to political liberalization and the second to inclusiveness. Malaysia is considered by many political scientists to be lacking in political liberalization.

[3] Democracies have, however, prevented the worst kinds of human tragedies, including famines, but they have not achieved the spectacular economic performance of dictatorships.

Hasan, Quibria, and Kim (2003) confirm a similar correlation between economic freedom and poverty reduction. In the context of a cross-country regression analysis, they find that economic freedom in the form of openness to trade, labor market flexibility, fiscal prudence and various types of civil liberties such as property rights and rule of law has had an important bearing on poverty reduction across countries globally. This finding however contrasts with that for political freedom, which seemingly has no direct impact on poverty reduction. However, this should not be interpreted to mean that democracy is unimportant for the well-being of the poor. Even if it is true that political liberties do not have any instrumental value in promoting growth or reducing poverty, they can be an important constituent of human well-being.

In light of the above discussion, how does one explain the success of the East Asian economies? The tautological answer is, of course, that the authoritarian regimes were more successful at fostering institutions and formulating and implementing policies that are conducive to growth and poverty reduction. These economic policies were reflected in their relative openness and liberal economic policies.

3. PROCESS OF POLICY MAKING

It is widely believed that liberal economic policies, which enhance long-term growth but inflict short-term costs, are easier to pursue in an authoritarian framework. This has much to do with the process of policy making in a society. According to Varshney (1999), the impetus for policies can be pressure from below or above. Of the two, pressure from above is common to both democratic and authoritarian polities. With pressure from above both systems can, in principle, help the poor if the political elite are firmly committed to poverty reduction and compel the state structure—particularly its bureaucratic institutions—to translate that commitment into public policy. The other source of policy, pressure from below, operates differently in the two systems. In a democratic polity, the poor can pool their weight to push the government's economic policy toward their interests through political mobilization and voting. Political mobilization and regular and periodic elections, which are common to democratic systems, do not exist in authoritarian polities.

Why then were the authoritarian regimes in the miracle economies more successful? Varshney (1999) attributes this to their success in promoting rapid growth, which in turn brought about a rapid reduction in poverty. Political regimes differ in their comparative advantage in exploiting different methods of poverty reduction. There are two principal methods of poverty alleviation: the direct method and the indirect method. The direct method generally entails distributive measures, including income transfers, such as food-for-work programs and credit and producer subsidies for small farmers; or asset distribution, such as land reforms. The indirect method is growth-mediated. While both methods can alleviate poverty, the indirect method, which relies on growth to create employment for the poor, seems to be more effective and sustainable in the sense that growth has a much larger impact on poverty and does not rely on the availability of public resources to sustain the process.

Irrespective of the superiority of one method over the other, the politics of direct and indirect methods of poverty alleviation diverge significantly. According to Varshney (1999, 5-6):

> Whether they are economically more productive or sustainable in the long run, direct methods—asset transfers or income transfers—have a clear logic and have effects that can be quite tangible. Most people, both politicians and others, can see the links proposed via land redistribution, land reforms can give land to those who have too little of it, or none at all; and via tenancy reforms, they can make poor tenants less dependent on the power and whims of landlords, potentially imparting a more secure source of income. A similar directness marks the symbolism of income transfers through credit and producer

subsidies. In contrast, the utility and value of the indirect methods of poverty-removal may be obvious to the scholars and specialists of development, but…is not easy to understand in political circles, and even if understood, rather difficult to push in political campaigns. The links proposed by the indirect method are subtle, and are also based on a long-run perspective…That is why in no developing country has *mass* politics, in which large numbers of average or poor citizens get involved (as opposed to *elite* politics confined mostly to the Westernized upper and middle classes), pushed for trade liberalization, currency devaluation and a market-oriented economic reform. A political constituency for economic reform may exist in the middle and upper classes, but it is still to be built among the poor.

According to Varshney (1999), this elite-mass distinction is critical to understanding the democratic political process. The reason democracies are more inclined toward distribution-oriented direct methods is that they are more amenable to pressure by mass politics.[4] As distribution-oriented direct methods are less effective at alleviating poverty in the long run, democracies in the developing world have been less successful than Korea; Singapore; and Taipei, China.

This does not, however, explain why an authoritarian ruler, who may be more insulated and less vulnerable than a democratic ruler to specific pressures, should be interested in playing a positive role in the development process. Olson (2000), who likened rulers to robbers, offered an explanation. He argued that a rational autocrat would behave like a “stationary bandit” with an “encompassing interest” in the

[4] Huntington (1968) and others have made a similar argument in a slightly different context. This argument posits that democracy undermines investment and generates an explosion in demand in current consumption.

productivity of society as a whole and avoid the deadweight losses arising from burdensome impositions on society's productive capacity.[5]

In light of these explanations, how does one explain the behavior of long-time autocrats who systematically plundered their economies? The answer is that in their cost-benefit calculus, these autocrats must have found that they would gain greater net benefits by plundering the economy than by investing in the expansion of its productive capacity. The policies that enhance a society's productive capacity, such as safeguarding property rights, enforcing laws and contracts, and streamlining bureaucratic procedures, are likely to influence both the stream of future outputs for extraction and the ruler's capacity to extract. Rulers' capacity to collect rents is contingent on the policies they pursue to promote productivity. In a bet between the certainty of the current arrangement and the unsure prospect of the share of a bigger pie, the "roving bandit" would prefer the certainty of the current arrangement.

There is an alternative political explanation for the positive productive role of autocrats in the economic development of the miracle economies. According to this explanation, as these autocrats came to power by nondemocratic means, they sought political legitimacy by undertaking ambitious development projects that promised the masses an improved economic future. In Korea and Taipei, China they also embarked on

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5 Drawing upon his earlier work, Olson (2000) introduced an insightful metaphor that distinguishes between a "stationary bandit" and a "roving bandit." A roving bandit takes away everything from his victims, while a stationary bandit has an interest in his victims' continuing prosperity and takes away only part of their incomes. According to this line of reasoning, an unstable autocracy will be more predatory than a stable autocracy, which has a longer time horizon and a more encompassing interest in the future prosperity of its subjects. Olson provides some empirical evidence from developing countries in support his hypothesis. While these metaphors are interesting, they do not take us too far analytically. The real question is then why some autocracies turn out to be roving rather than stationary bandits. The real reason may have something to do with social and historical factors, but they are yet to be fully explored**.**

programs that represented nationalist goals, such as catching up with Japan or warding off the communist threat (World Bank 1993).

4. NATURE OF BUREAUCRACY

Some observers have suggested that the miracle economies did an excellent job of providing a good institutional framework for policy making. They succeeded in insulating their bureaucracies from the pulls and pushes of short-run, pork-barrel politics. The conditions that purportedly promoted this insulation include highly selective meritocratic recruitment and long-term career rewards for members of the bureaucracy. This insulated bureaucracy was entrusted with the task of formulating long-run development policies and guiding their implementation. Proponents of this view often cite the role played by such powerful, semi-autonomous, technocratic organizations as the Economic Planning Bureau in Korea; the Industrial Development Bureau in Taipei, China; and the Economic Planning Bureau in Malaysia.

Given independence, the insulated bureaucracies carried out their responsibilities with a degree of efficiency that is difficult to maintain in a democracy encumbered by pork-barrel politics.[6] However, autonomy can be a double-edged sword: it can lead to bureaucratic indifference, inflexibility, and inefficiency, especially when markets and technological conditions are uncertain. In addition, an autonomous bureaucracy may lack the flexibility required for error correction.[7] However, Bardhan

[6] Many authors, including Weber (1968), have emphasized the need for bureaucratic insulation. Weber suggested that a simple correlation exists between a modern economy and an insulated bureaucracy.

[7] Evans (1992, 148) argued that economic development requires a "developmental state", which requires a bureaucracy that is both insulated and "embedded." According to Evans, embeddedness requires that the bureaucracy possesses "accurate intelligence, inventiveness, active agency and sophisticated responsiveness to a changing economic reality." If the bureaucracy is embedded, it can perhaps overcome inflexibilities.

(1999, 11) suggested that the bureaucracies in the miracle economies were not necessarily inflexible:

> This flexibility has been maintained in East Asia by fostering a dense network of ties between public officials and private entrepreneurs through deliberative councils (as in Japan or South Korea) or through the tightly-knit party organization (as in Taiwan), allowing operational space for negotiating and renegotiating goals and policies, sharing information and risks, and for coordinating decisions (and mutual expectations) with remarkable speed.

Not only did the bureaucracies implement the development agendas of the authoritarian regimes efficiently, they have also been credited with introducing innovative incentive designs in the form of economic "contests" (World Bank 1993). The basic idea of the contest—which is presumably organized around the three Rs, namely, rules, referees, and rewards[8]—is simple. Firms receive various economic supports (rewards), but only on the basis of clearly defined criteria (rules) and in the presence of an enforcement mechanism (referees). Given its power, independence, and incentives to remain honest, the insulated bureaucracies ran these contests fairly and yielded the best of both worlds of collaboration and contests (World Bank 1993).[9]

[8] According to the World Bank (1993), there are three conditions for a successful contest. The rewards must be substantial, the rules must be explicitly stated, and the referee must be impartial.

9 According to the World Bank (1993), the management of the miracle economies was similar to a contest-based competition, where for well-defined "prizes", firms collaborated with each other where collaboration was needed for sharing information and promoting interdependent investments and competed with each other where competition was needed.

In short, the miracle economies seemed to have succeeded in capturing the good aspects of bureaucratic insulation while avoiding the bad ones. But the question is: Is authoritarianism necessary for bureaucratic insulation? Bardhan (1999) has correctly pointed out that authoritarianism is neither necessary nor sufficient for bureaucratic insulation. In East Asia, postwar Japan successfully insulated parts of its bureaucracy without giving up democracy.[10] By contrast, despite the powerful Marcos dictatorship, the Philippines could not achieve bureaucratic insulation. Similarly, in other parts of the world, despite authoritarian regimes many countries became more like the Philippines than Japan.

While the miracle economies provided their bureaucracies with a large degree of insulation from political pressure, no convincing explanation is available to account for why they succeeded whereas other countries failed. For example, despite the highly selective meritocratic recruitment and long-term career rewards for bureaucrats, the insulation of the bureaucracy in post-independence South Asia was only short-lived. Under the rough and tumble of its raucous democracy, within a decade of independence India's bureaucracy lost its insulation and became an integral part of the rent-seeking process, while the bureaucracy gradually lost some of its traditional insulation in terms of security of tenure and autonomy in policy formulation. In South Asia, even though senior civil servants are still largely protected by a tenure system, they can be subjected to harassment and humiliation, including frequent job transfers to hardship positions in poor locations, when they incur the wrath of powerful politicians.[11] In recent years, the cadre of senior civil servants in some of these countries has seen occasional incursions by outsiders such as army personnel or political loyalists. The

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10 However, some authors have branded Japan's democracy as "semi-authoritarian" in the sense of not being fully politically liberalized (see Richardson 1997).

15 In many other parts of the developing world, selection to work in the bureaucracy is often more a matter of political patronage than of individual merit. This is particularly true in many parts of Latin America and Africa.

determining factor for such entry into the cadres has, of course, not been their bureaucratic competence or technical excellence but political loyalty.

How does one reconcile the contrasting experiences of bureaucratic insulation? The existing theories seem to shed little light on the subject. Srinivasan (1997, 30) eloquently expressed this inadequacy of theories in relation to India's experience as follows:

> The lesson from the Indian experience is that it is simply not enough to assert that, given a framework of appropriate rules, rewards and their impartial enforcement…rapid growth will come about. It is also necessary to show that the incentives to deviate from the specified rules, for the referee to collude in condoning such deviation, etc., were absent. In fact, the range of government assistance in the form of subsidies, access to rationed credits and foreign exchanges, tax exemptions and so on was provided to exporters in many developing countries….But such assistance did not result in export performance similar to that of the miracle economies. The point is that without a deeper political-economy analysis to back it up, in particular whether or not an authoritarian framework committed to development is at the root of the impartiality of the referees, the three R's (Rules, Referees, Reward) are no more than catchy slogans. Indeed, why the authoritarian leaders of the miracle economies seemed to have been committed to development, while those of Nigeria, Philippines, and Zaire were apparently not, needs to be analyzed.

In short, we still have much to learn about how the miracle economies achieved their bureaucratic insulation and at the same time ensured the efficiency of their bureaucracies.

5. NATURE OF ECONOMIC GOVERNANCE

The nature of economic governance has a critical bearing on economic development. A well-governed economy that secures individual property rights, ensures the rule of law, contains the extractive behavior of the government, and offers a credible policy framework is more likely to succeed than one that fails to obtain such conditions. There are many distinct dimensions of good governance. The following discusses four salient aspects of governance where the authoritarian regimes in the miracle economies have had notable success.

Credible Policy

Some authors have suggested that an economy's success depends to a large extent on its ability to credibly precommit to policy (and to avoid any time inconsistency problem). The ability to precommit to policy depends on the nature of the state, that is, whether it is a "strong" or a "weak" state. A strong state is said to be an autonomous state. The autonomy of a state has been defined by the degree to which it can formulate and pursue its goals without being encumbered by the demands and interests of special interest groups or social classes. Some economists have stated this distinction more formally in terms of the metaphors of game theory. According to Rodrik (1997), rulers in strong states are Stackelberg leaders: they commit themselves to a particular policy, based on their welfare-maximizing calculus, and taking into account the reaction of private actors to the policy. In contrast, rulers in a weak state are Stackelberg followers: they cannot commit to a particular policy, but merely react to the independent actions of private actors like special interest groups. Thus compared to the strong state, the weak state will have few abilities to pre-commit and make too many undesirable interventions.[12] In the words of Haggard (1994, 83): "Strong states [are] a

[12] A fairly large political science literature is available on this topic. According to a well-known study by Migdal (1988), the principal distinction between weak and strong state lies in rulers' inability in weak states to govern effectively and pursue a broad political and social agenda as they remain engaged in brokering conflicting demands from interest groups.

crucial prerequisite for reform, important not only in guaranteeing the relative efficiency of interventions at the microeconomic level…but for the coherence of economic policy more generally."

Some authors have suggested that the miracle economies are exemplars of strong states. One can find a number of successful examples of precommitment to policy under the authoritarian regimes of the miracle economies in the area of infant industry protection, particularly in Korea and Taipei, China.[13] The governments in these economies held steadfastly to their commitment to withdraw protection after a preannounce date. Proponents of this view suggest that this precommitment to policy was critical to inducing the protected industries to shape up to international competition. While democracy may be helpful, it is not necessary for establishing the credibility of commitment. Indeed, as democracy spreads to these economies, the evidence indicates that their governments' ability to commit and their resolve to stick to prior commitments have become weaker.

Rule of Law

In simple terms the rule of law refers to a society's adherence to its existing rules and regulations. This implies a legal system where laws are public knowledge, are clear in meaning, and are applied equally without any arbitrariness. It also implies that the government is embedded in a legal framework that constrains arbitrary actions on its part. The precondition for establishing the rule of law is a strong judicial system that is fair, competent, and efficient and not subject to political manipulation.

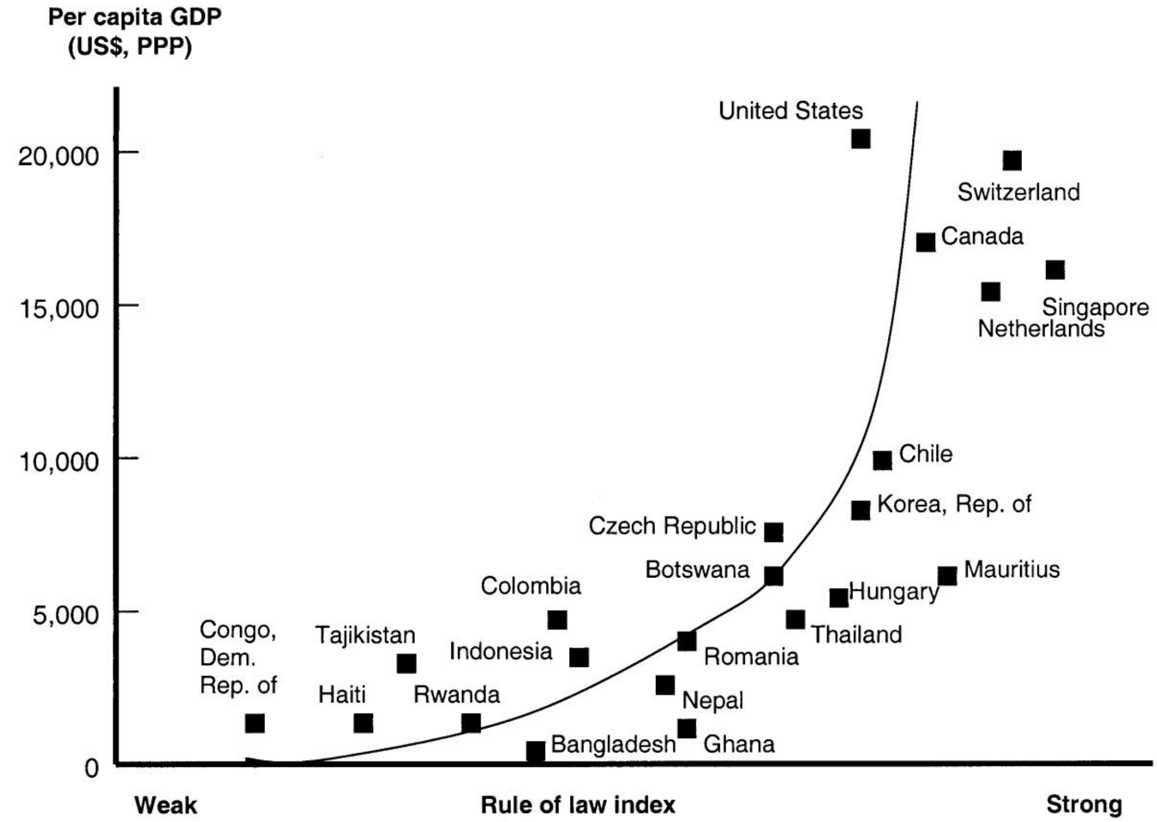
The rule of law has important implications for economic development. To sustain economic growth, one needs not only the freedom of personal economic choice

[13] Some have suggested that credible and effective precommitment requires democracy. According to this argument, a ruler's promise is more credible if a well-established procedure exists for dethroning the ruler for reneging on a promise.

and the freedom of exchange and production, but also such basic market institutions as property rights and contracts, which need to be founded on the law. Similarly, major economic organizations, such as firms, trade unions, and banks, cannot function without the rule of law. Similarly, the government cannot carry out its role—as economic regulator, tax collector, monetary policymakers, and so on efficiently and fairly—without a legal framework. The empirical literature suggests that the rule of law has a profound impact on economic growth. According to a study by Kaufmann, Kraay, and Zoido-Lobaton (2000) of 166 countries in 1997–98, a strong positive correlation exists between per capita GDP and the rule of law (Figure 2).

Figure 2. Relationship between Rule of Law and Per Capita GDP,

Selected Economies, 1997–98



Note: PPP means purchasing power parity.

Source: Kaufmann, Kraay, and Zoido-Lobaton (2000).

The miracle economies did a commendable job of upholding the rule of law in the economy (although they fared badly when it came to the political arena). The miracle economies have a good record of defining and enforcing property rights.[14] As

[14] Acemoglu, Johnson, and Robinson (2001) attributed the principal reason for the success of Botswana, the African miracle, to good institutions, particularly its effective property rights systems against state appropriation and predation by private agencies. Given the country's relative political stability, it was able to maintain the continuity of

Bardhan (1999) rightly noted, over the last three decades, the ruling family in Indonesia and the government in Taipei,China have provided the predictable and durable contractual environment that private business needs to thrive without the procedural formalities of a democracy. By contrast, despite the existence of an admirable legal and contractual infrastructure, in some democracies the courts and the administrative arbitration machinery were largely ineffective and offered little legal protection to contracts and property. It is highly likely that business people would find their connection with a durable politician in an authoritarian regime more valuable than the ineffective legal infrastructure of a democracy.

Nevertheless, while many presume that democracy provides a better institutional framework for securing property rights, many others disagree with that view. In the words of Przeworski and Limongi (1993, 52): "The idea that democracy protects property rights is a recent invention, and we think it is a far-fetched one." They argue that in a democracy where most people are poor, the property rights of the rich may always be threatened, as the poor, who suffer as a consequence of private property, will use their power to vote to appropriate the wealth of the rich. In this regard, Bardhan (1999) contends that while democracy may be ideologically more hospitable to the rule of law, what is really important for business to thrive is predictability rather than legal accountability. In the past, many authoritarian regimes were more successful than democracies at providing a framework for predictable contracts.

While a democracy may uphold the rule of law, not all enacted laws are conducive to development.[15] Even in the industrial countries the legislative process is

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property rights and effective constraints on rulers and political elites to limit arbitrary and extractive behavior.

15 There is no agreement on whether democracy does uphold the rule of law. In a recent quantitative study, Barro (1995) could not find any statistical association between democracy and the maintenance of the rule of law.

subject to enormous interest group pressures. In many countries, because elections have become enormously expensive, this problem of influence peddling has worsened over time. Given the disproportionately large influence of campaign contributors in many democracies, legislative outcomes are often determined by influence bought by campaign contributions rather than by the imperatives of development priorities. Consequently, in the list of priorities, development projects often get short shrift in a democracy. If the allocated funds are badly managed or the laws are inimical to development, whether the legislated policies are implemented efficiently by an insulated bureaucracy or adjudicated in a neutral court system in a democracy is unimportant.

Limited and Centralized Corruption

Many claim that the miracle economies were largely free from bureaucratic corruption because of the insulation of their bureaucracies. While corruption existed, the nature of such corruption was different from that in other developing economies, in that it was essentially centralized in the form of lump sum payments to top politicians or to the highest echelon of the bureaucracy.

Shleifer and Vishny (1993) have suggested that centralized corruption has less adverse consequences for resource allocation than decentralized corruption. The underlying logic of their proposition can be stated in terms of the "industrial organization" of corruption. Consider an example of centralized corruption, where to secure an import license the importer must pay a high-ranking functionary in the ministry of trade who has monopoly power over a set of complementary services. By contrast, in the case of decentralized corruption, the importer must pay a large number of low-ranking officials in different ministries who are involved in processing the import papers. For the importer, a centralized bribe is considerably less trouble than a decentralized bribe. The difficulties increase as the number of bribe takers in the chain increase. Shleifer and Vishny argue that where corruption is decentralized and bribe takers have monopoly power over a gamut of complementary services—such as foreign exchange licenses and import permits—then corruption becomes analogous to the double marginalization problem in industrial organization theory.[16] In the double marginalization problem, monopoly distortions are magnified with the addition of each extra element of distortion. If corruption is centralized, the high-ranking official internalizes all the costs of distortion at a much lower cost to the importer and to the economy.

Local Level Accountability

Democracy has its own accountability mechanism that limits the abuse of executive power. This accountability works through a system of periodic elections that reward and punish elected officials for their successes and failures in managing the economy. While elections can be a potentially powerful incentive mechanism for development, the success of democracy in fostering rapid development is at best mixed. In poorer countries, this incentive has been more potent in averting major economic disasters than in addressing the continuing problem of persistent poverty. This problem has been eloquently expressed by Bardhan (1999), who noted, "In a democracy it seems easier to focus political attention to dramatic disturbances in a low-level equilibrium, than to the lowness of the level itself." Comparing PRC and India, Sen (1983) concludes that democratic India, with its free press and vigorous opposition parties, has been more successful than the PRC in averting sporadic threats of famine and deaths from starvation, but less successful in addressing endemic hunger and malnutrition.

There is however no strict functional relationship between the nature of the political regime at the national level and local level accountability. Some democracies have done a poor job of fostering local level participation and ensuring local

[16] If the services provided are not complements, but substitutes, for example, passports issued by a number of competitive agencies, then decentralization and the presence of multiple agencies would reduce corruption.

accountability whereas some authoritarian regimes have fared well in creating participatory institutions at the local level. In this connection, Wade (1997) highlighted some interesting contrasts between authoritarian Korea and democratic India in the modes of operation of their irrigation systems. He found Korea to be more locally decentralized and effective than India in responding to farmers' needs. In India the irrigation system is large and the bureaucracy is overly centralized and operates according to rules that minimize identification between irrigation officials and local farmers. By contrast, Korea's bureaucracy is largely decentralized, with operations and maintenance activities essentially delegated to local farmers' associations, which are knowledgeable about local conditions and responsive to local needs.

Similarly, a comparative study of the primary education system in the PRC and India (Dreze and Saran 1997), which focused on the experiences of two villages, found that the PRC is more successful than India in the provision of primary education because the PRC has better institutions of local accountability than India. The Indian village had no village government that could supervise the district administration. Moreover, the village's caste-ridden politics precluded any possibility of collective action to improve the school. In contrast, the Chinese village had an effective village government as well as a party organization that monitored the functioning of the school.

6. CONCLUDING REMARKS

As the foregoing review suggests, a critical factor behind the economic and social transformation of the East Asian miracle economies has been their ability to nurture robust institutions of economic freedom and ensure efficient economic governance. These economies have at the same time been managed by authoritarian or semi-authoritarian regimes. Does this mean that good policies and institutions need to be embedded in an authoritarian regime? The answer in our view is no. Indeed, there is no reason why a well-functioning democracy should be inimical to economic development, although the comparative review of Asian experience suggests that in the past, democracies have been less than a resounding success in nurturing and sustaining a conducive environment for economic prosperity.

It has been suggested that democracies do not necessarily guarantee credible policies. However, this should not be the case. A well-functioning democracy, with its checks and balances and periodic elections, provides an adequate framework for credible polices. Notwithstanding the conflicting pulls and pushes of democracy, recent reform experiences in developing countries suggest that it is possible for an enlightened leadership to embark on —and successfully pursue—a reform agenda of economic liberalization for long-term economic growth. However, as these reforms often lead to winners and losers, they need to be accompanied by social safety nets for those who fall by the wayside. When skillfully designed, these policies can be “winners” even in a highly competitive political environment.

It has been argued that new democracies in the developing world encompass no more than the right to vote, which, though important, has a much less critical bearing on economic welfare than such basic economic liberties as secure property rights which are fundamental to economic development. Historically, in the mature western democracies, political liberties developed side by side in sync with economic liberties. However, this has not yet happened in most new democracies in the developing world where economic freedom is weak or poorly developed. However, there is no reason to believe that economic liberties cannot blossom in developing countries.

It has been noted in light of Asian development experience that democracies often breed dysfunctional corruption or they do not ensure local level accountability. However, there is no inherent reason that this should be the case. Democracies, with their appropriate legal regulatory frameworks, free press and vibrant civil society organizations, can be an effective antidote to corruption. Some recent experiences in South Asia, particularly India, bear testimony to this. Similarly, it is possible to improve local level accountability with greater decentralization and local level participation. Improving people's lives at the grassroots level requires effective and efficient delivery of local public goods. Here the role of local level accountability is salient and enhancing the depth and breadth of local-level decentralization is the key. In sum, a well-functioning democracy, if conjoined with appropriate policies and institutions, can be effective in engendering economic development.

Finally, no matter whether there is any causal link between authoritarianism and development, it would be wrong to suggest that the new democracies revert to authoritarianism to nurture economic freedom and foster development. Political scientists have made a distinction between liberal and illiberal democracies. Many fledging democracies are illiberal democracies. The future challenge for these illiberal democracies is not to make a transition from a democratic to an autocratic regime, but to foster greater constitutional liberalism in otherwise illiberal democracies. The logic of the choice is simple, which is lucidly expressed by Dasgupta (2000, 32): "Good authoritarianism can't be willed by citizens, bad authoritarianism regimes are hard to get rid of. A central problem with authoritarianism is lack of incentives for error-correction."

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