Is democracy good for economic growth?

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Abstract

The relationship between democracy and economic growth has long been debated. Over time, views on the relationship between democracy and economic development have changed. According to me democracy neither causes nor depends on economic growth. Democracy is a contextual thing which may be positively or negatively related to economic development at different situations. Democracy promotes economic development when it provides stable political condition and the policies suite to the economic development. It may retard economic development when the policies do not support the economic uplift and it has conflict with social tradition or public expectations. Even if someone proves the correlation between economic growth and democracy, the direction of the causation remains a question.
Introduction

The relationship between political democracy and economic growth has been a center of debate in the past fifty years. In the 1960s and 1970s democracy and economic growth were often considered as competing concerns. Bhagwati (1966): “the political economy of development poses a cruel choice between rapid (self-sustained) expansion and democratic process”. Barro’s (1996) work, predicts an”inverted U-shaped” reaction of growth on democracy, i.e. movement from authoritarianism to democracy first encourages economic growth, but after a certain threshold hampers it. Barro himself explains the inverted U-shape by the fact that in the worst dictatorship, an increase in political rights might be growth-enhancing because of the benefit from limitations on governmental power. But in places that have already achieved a moderate amount of democracy, a further increase in political rights might impair growth because of the intensified concern with income redistribution”. Thus the “moderate” democracy appears to be the optimal choice in the trade-off between governmental rent-seeking and public desire for redistribution. More recently, authors often came to more optimistic conclusions. Rodrik (2000, p. 22): “Recent empirical studies based on samples of more than 100 countries suggest that there is little reason to believe democracy is conducive to lower growth over long time spans.” Scholars argue that democracies have embedded institutional advantages that support economic development. According to Nobel laureate Amartya Sen, democracies enrich individual lives through the granting of political and civil rights, and do a better job in improving the welfare of the poor, compared to alternative political systems. They provide political incentives to rulers to respond positively to the needs and demands of the people. The open dialogue and debates inherent in open democracies aid in the development of values and priorities, and this “constructive function” of democracy can be very important for equity and justice.

Economic growth and democracy: Case of India and China

Democracy is desirable for a nation because it widens individual freedom and capabilities. But the freedom of choice is hardly a prerequisite for economic growth. No doubt democracy is a good thing, but to relate democracy to economic development is a rather complicated effort both conceptually and empirically. Let’s consider the case of India and China. India has overcome its
abysmal rate of growth to record impressive economic gains over the past decade. But China's stunning growth in its GDP has been sustained over a longer period, averaging 8 percent or more a year for more than two decades. Is India's slower economic growth a price of democracy? Not so. India's economic sluggishness for four decades was due to bad policies, not weaknesses inherent in democracy. Policies of economic autarky, import substitution and industrial licensing; fear of foreign investment; and rejection of market principles were conscious choices made by the ruling elite that had nothing to do with liberal democracy per se. The economic performance of both countries changed dramatically without any change in their basic political systems, once they abandoned their old socialist dogmas, deregulated their economies by adopting market principles and engaged with the international economy. China did this earlier, and so its growth has been the longer and its share of world trade is the more substantial. Democracy would appear to be irrelevant to their common failure before and their parallel success after economic reforms.

Of course, there are also constraints in each country's rise. Can China triumph without democracy? Certainly its government has liberalized with regard to the economy, but not much yet on citizens' rights. The "protest zones" at the Beijing Olympics—in which nobody was actually allowed to protest, and many would-be protesters were arrested—is yet more evidence that capitalism and fairly open communications do not equate to democracy. Yet one need only glances at the skyline of Shanghai or visit a manufacturer in Shenzhen to see that this is a country that knows how to get things done.

In India, one sometimes feels that a benevolent dictatorship (much more benevolent than that of China) would do the country some good. It's quite a democratic country, but it seems difficult at times for leaders to stop arguing and get things done. The kerfuffle over the new Tata Motors plant in Singur, West Bengal, is a good example. Tata Sons chairman, Ratan Tata, chose this area considering the economic development it can get. Yet local officials, ostensibly fearing that farmers would lose their land, held up the deal to build the plant for months. And what happened after that is no hidden.
**Democracy fosters good governance**

It is imperative that both liberal democracies and market economies rely for their long-term success on similar attributes of good governance: healthy competition, access to free and full information, secure property rights, the sanctity of contracts enforceable by an independent judiciary, a multi-skilled and well-educated workforce and citizenry, an efficient and transparent legal system, prudential regulatory systems, merit-based recruitment and promotion, and executives who are accountable to shareholders for the mistakes they make as well as answerable to the courts for the legality of their actions. Markets require governance; good governance is not possible without democracy and civil society. Democracies also facilitate the achievement of the necessary social compromises between capital and labor, efficiency and equity, and growth and equality.

According to a research by Elias Papaioannou and Gregorios Siourounis, countries which have experienced a transition to democracy experience higher average growth after the transition. The graph below, from the paper, plots the evolution of real per capita GDP growth in the years surrounding a successful democratization (the year of the democratization being T), compared to the global growth rates in each year. The average growth is the purple dashed line. The graph also shows that the transition itself may imply economic costs, but in the longer term democracy pays off.
Reasons why democracy may be good for economic growth:

- Only governments with some legitimacy will be able to implement and sustain policies that may bear high short-term costs.

- Various of the institutional characteristics of a democracy, like an independent legal system, are also required for a successful liberalization.

- Democratization may limit rent-seeking due to its system of checks and balances. Rodrik (2000) said that democratic institutions - political parties, elected representatives, free speech, and the like - can be viewed as the ultimate institutions of conflict management, as they allow for differences among social groups to be resolved in a predictable, inclusive, and participatory manner.

But:

- Democracy may lead to policies that hamper economic growth (rich-to-poor redistribution, large public sector, high taxes) due to majority voting.
• Influence of interest groups can reduce flexibility of the economy. Development needs a state isolated from the pressure of interest groups. In democracy this pressure arises from individuals: those who act collectively as economic agents undertake investment, and can organize themselves to ensure income transfers in their own interests.

Now, democracy is of course desirable for many reasons, and most of these are unrelated to the economy. But the fact that democracy produces economic gains will make it even more attractive.

Conclusion

Since economic growth arises from good policies, people tend to think that politics (democracy here) affects the policies. But, in fact, good policies have always been rooted in more complicated sources and institutional settings rather than just political processes. This is why economic growth happens in both democratic and authoritarian states as long as they can produce good policies and institutions for capital. In sum, however, the conclusion is that to the extent any relationships exist between democracy and economic growth they are weak ones. Democracy and economic development are the ends to be achieved in a sustainable way, and this cannot be guaranteed without the greasing and conditioning process of good governance.
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