

Freedom, Prosperity and the Struggle for Democracy

Ideas on Liberty

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Introductory texts

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liberal Verlag GmbH

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Introduction

The messages of liberalism have been incorporated into a growing international consensus concerning good governance. The most visible is the international bill of rights, encompassing the *Universal Declaration of Human Rights* and the two international covenants on civil and political and on social, economic and social rights. Arguably, and taken together, the standards espoused in these legal instrp2r01 ncompassifailurear

of *Amnesty International* are full of cases of political prisoners whose “crime” it is to struggle for democracy. Rule of law, the institution that protects freedom, is seen as an institution that is important not only for personal security and the protection and enforcement of rights, but also as a precondition for investment and economic well-being. The Chinese authorities are increasingly interested in the subject. Recently, we have even seen intense discussion of “international rule of law.” Many international NGOs are pursuing a liberal agenda – in the field of human rights, in the fight against corruption, for instance. Think tanks, with their international networks, are promoting awareness of the importance of economic freedom and competitiveness.

And yet, despite an emerging international liberal consensus and the institutions that support it, we cannot say that liberalism has won the political debate. Attac¹ stands for the opposite approach.

Liberalism is still met with scepticism in many parts of the world. It is equated by political activists of the left with lack of compassion and with lack of interest in the well-being of the poor. It is equated with the interests of business, especially big business, and with globalisation – with its supposedly harmful effects. A large number of opinion leaders in Africa and Asia see liberalism as the product of “western” culture with little interest in traditional cultures of other parts

1 *Association for the Taxation of financial Transactions for the Aid of Citizens*, one of the leading and most outspoken anti-globalist organisations.

of the world.² Liberalism is regarded as dangerous by conservative clerics, Catholic, Islamic or other, throughout the world.

Others look aghast at “cut-throat competition” and its purported negative effects – ascribing it to liberalism or its reincarnation, neo-liberalism. Such competition, it is claimed, has harmful consequences for the environment and for “social cohesion.” The fact that it promotes innovation and is a boon for consumers – which we all are – is conveniently ignored.

Many politicians fear liberalism for another reason: because it is a threat to their power. The liberal call for a lean state is a threat to a political and administrative caste that derives its influence and privilege from the ability to decide who in society gets how much. There is another fear: the feeling that economic liberalism promotes, perhaps unwillingly, a transfer of power from politicians to markets, from politicians to business, and that this is something bad.³

The criticisms of liberalism are many and well-known. Many such criticisms, especially those that focus on the idea that

2 It’s interesting to note that the same isn’t said for socialism, for feminism or for modern environmentalism, all of which have their immediate origins in Europe or the United States. The criticism ignores that liberal thinking exists in other cultures and that, in part, modern political and social main-streams have developed as a response to changes brought about by secularisation and industrialisation.

3 If I were a citizen of Cuba, I would certainly prefer to be governed by the *Coca Cola* corporation with its tradition of good governance.

liberalism promotes a process in which the rich get richer and the poor poorer, represent a form of social Darwinism and ignore human complexity, culture and inventiveness.

The aim of this book is to marshal and present evidence in favour of a comprehensive liberal approach to policy, irrespective of whether the liberalism in question is economically or politically motivated. The argument is that

- economic liberalism complements political liberalism and vice versa,
- that liberal economic reform has political consequences that are desirable from a liberal point of view and
- that liberal political objectives such as freedom and democracy (of the kind that promotes and enhances liberty) have positive effects on economic and hence, ultimately, on social well-being.

Although I believe that freedom, *political and economic*, is an end in itself and, indeed, the most important objective of development, many of my contemporaries would not agree. The evidence I present in this book on the beneficial effects of freedom in its various aspects is directed at those who need to justify their actions in terms of increasing well-being or welfare in a measurable way. Of course, this is not always possible. However, I was surprised by the amount of evidence that I could find.

The book is not an academic piece of work, nor does it intend to be. It surveys and uses a lot of recent data that support

the liberal approach. It doesn't attempt to address details, important as they may be. The approach is global rather than local. I am trying to paint a broad picture. If the book succeeds in encouraging the reader to question accepted wisdom, to see liberalism as a comprehensive and consistent way of thinking and to accept that liberal policies benefit the ordinary man or woman in the street, at least in the long term, it will have fulfilled its "mission."

Personally, I think it strange that only 14 years after the velvet revolution, a revolution against socialism that represented the final damning comment on the viability of a command economy, economic planning and social engineering, people still place so much trust in the economic abilities of politicians and bureaucrats whose primary function was never an economic one. Indeed, throughout the world successful businessmen tend not to enter politics or the civil service. And yet many believe that wealth can be engineered through intervention and redistribution. What is more: many seem to behave as if they believe it can be engineered by non-experts. There is plenty of evidence to show that liberal policies create jobs – and jobs are the basis of social security in more senses than one, but the evidence, plentifully available, is ignored.⁴ We tend to trust markets in the political sphere: competitive elections. We shouldn't we trust economic markets to the same extent?

Liberal parties are one of the victims of scepticism. We see the dichotomy of universal acceptance of liberal standards

on the one hand and the obvious weakness of “organised liberalism.” Part of this is due to the fact that many liberal values are generally accepted, though they might not be given the importance of other values.⁵ Part is due to the fact that many see no role for liberalism in a world of universal liberal standards – which conveniently ignores the fact that policies in many “liberal” countries are illiberal. Witness, for instance, the recent incursions into the private sphere of citizens and into civil rights as a reaction to terrorism. Witness the EU juggernaut with respect to economic and social regulation. A large part of this weakness, of course, is due to infighting among liberals, a subject I will deal with briefly in the next chapter. Other reasons include a tendency towards self-criticism, which is admirable, but a tendency that also sometimes engenders lack of self-confidence and an ambivalent approach to power. But we shouldn’t over-dramatise

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- 4 In a number of European countries, the emphasis is still on state-led job-creation programmes despite the experience and success of countries that place more emphasis on market-oriented policies. The success of Ireland is explained by pointing to EU subsidies, ignoring the question why Greece hasn’t achieved similar results. The fact that billions have been pumped into the eastern part of Germany and unemployment remains at 20 % is ignored. Indeed, official statistics on such transfers are no longer readily available. The US “job machine” is misrepresented in many European countries as a job machine that survives on the multiplicity of “inferior” so-called *McDonald’s* jobs.
 - 5 Many social democrats, for instance, accept the importance of freedom but emphasise the pre-eminence of solidarity and “social justice” as defined by their representatives and certain vested interest groups. Conservatives tend to stress order and security at the expense of freedom.

the situation. Many relatively successful European countries have strong organised liberal movements.

This book, I hope, will contribute to a more informed debate, more self-confidence in presenting the liberal case and, in a small way perhaps, to a strengthening of liberalism. There is no reason to be apologetic. Liberal values are good in themselves. Many, if not most, humans aspire to liberty and economic well-being. But there is more. Empirical evidence shows that liberal policies are better than their alternatives in enhancing freedom and prosperity on a wide scale and in the interests of the many rather than the few.

The first chapter deals with the inter-relationships between freedom in its economic and political dimensions, among them human rights, and economic well-being. The second deals with the relationship between freedom and democracy, attempting to show that democracy only makes sense if its purpose is to enhance freedom. The third chapter looks more closely at democracy and the economy and attempts to dislodge the misconception that democracy, or too much of it, is bad for economic progress. The fourth chapter addresses wide-spread pessimism concerning human progress in the economic and social spheres, arguing that the achievements of the contemporary world are considerable and that, given the right policies, development on a broad scale encompassing all fellow human beings is possible. Here my purpose is to dislodge the attitude that the task is so overwhelming and hopeless that there's no point in trying. It also tries to show that economic growth, and the eco-

conomic freedom that promotes substantial growth (next chapter) does not per se generate more inequality. Being left behind is not inevitable but due to the effect of bad policy in those parts of the world concerned.

Human rights and economic freedom – European and wider perspectives

In Europe liberals tend to be categorised as economic liberals or social liberals. The economic liberals – sometimes called neo-liberals, sometimes libertarians, depending on the national context – are seen to be primarily interested in promoting the idea of free markets. The social or left liberals were and still are often considered to be a) the liberals with a social conscience and b) the liberals who campaign for rights. This division between the two is certainly not in keeping with liberal tradition. In the 19th century, there was little tendency to separate the economic, social and political realms from one another. The separation between the two was cemented by the intense competition between liberals and the dominant socialist and social democratic main-streams in Europe after the beginning of the 20th century right up to the late 1980s. The left liberals came to sympathise with some aspects of the socialist analysis of economic reality – even if they rarely agreed with socialist solutions. Today, the differences are fast disappearing because few would dispute that a free market has a better record in producing prosperity and the foundations for welfare than a command economy or massive state intervention in the eco-

conomic process (nationalisation of industry, state objectives and priorities for the economy, massive regulation of the labour market, to mention but a few examples).

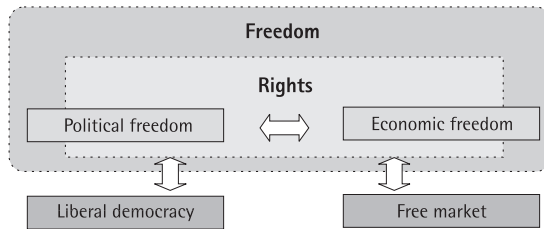
Looking at things from a different perspective: human rights activists tend to avoid associating with economic liberals. Indeed, they tend to see free markets as being outside their immediate realm of concern. Some human rights activists are not so neutral and see links between “capitalism” and a) human rights violations, particularly in developing countries, and b) social injustice. This is somewhat puzzling, given the fact that the liberal and human rights movements, if not the same thing, share an intellectual tradition, at least as far as civil liberties and political rights are concerned. Looking at the *Universal Declaration of Human Rights* and the two international covenants on civil and political and economic social and cultural rights (the so-called international bill of rights), this tradition is still a shared one. It would be difficult to describe the standards set by the international bill of rights as anything but liberal.

Why the antagonism? The question is difficult to answer, but I believe it is still one of the many intellectual leftovers of the Cold War.

If liberals were split in two camps, they were wrong to allow this to happen. If relations between liberals and human rights activists were at times strained, they were both wrong not to make greater efforts to repair them.

I prefer to see rights as a sub-category of my freedom as an individual. Indeed, the major part of the freedom we enjoy may be said to be the outcome of respect for human rights (see figure 1). Some of the rights I have contribute to my political freedom, some to my economic freedom. They are, of course, interlinked in many ways. Some examples:

FIGURE 1:
Freedom in general,
human rights and
economic freedom



1. Mutual effects: My right to vote has effects on the economic policies that are enacted. These policies may either enhance or diminish my economic freedom. Violations of citizens' property rights will influence the political decisions they make.
2. Relative importance: who is to say that I have a right to make a political choice (= democracy) but no right to make an economic choice (= economic democracy)? Is the one inherently more important than the other? I believe it is impossible to rank categories of rights in order of importance. Is the right to freedom of expression more important than the right to own and run a business – or don't both depend upon another? It isn't an accident that freedom of expression, and a free press, is a phe-

nomenon of open societies and, by the same token, it isn't an accident that press enterprises flourish and expand not in closed, but in open societies?

3. Experience: both political and economic freedom tends to be found in the same societies. Liberal democracy is the outcome of respect for civil liberties and political rights. A free market is the outcome of respect for economic freedom. The liberal democracies of this world are the countries with free markets.

An environment in which rights are protected and enhanced is an interesting environment for business and commerce. A topical example: it is quite easy to see why India has become a centre for software development in the global economy and China so far hasn't. The same holds true in the other direction. A healthy business environment is good for human rights: The Internet, a commercial enterprise with incredible rates of expansion over the last 10 years, has given citizens power and influence that would have been inconceivable two decades ago. Today we are aware of human rights violations where, twenty years ago, we might have had vague suspicions, nothing more.

The following graphic offers an interesting insight into the relationship between human rights, the subject of this article, and level of prosperity. The major conclusion one can draw when looking at the top right hand quarter is that: *World-wide there is no example of a wealthy country with an abysmally bad human rights record* (figure 2).¹



Some may object and point to the example of Saudi Arabia, for instance (figure 2, arrow), a moderately rich country without a good human rights record. But it is a case apart. Wealth is built upon the superabundance of a single commodity: oil. And the loyalty of its citizens is based on the generosity of its ruling house. There are exceptions, but they are few.

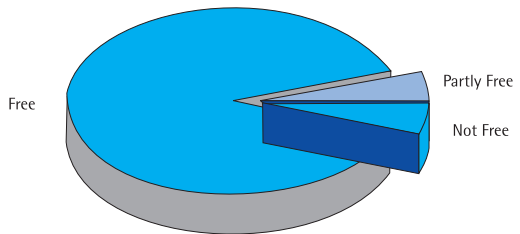
If we take a closer look at figure 2 we will also see that there are many poor countries with very bad human rights records (bottom left). This is also what we would tend to expect. We

are then left with a third category (top left), that of countries like India, in fact quite a lot of countries, with a fairly good human rights record but with a poor economy – suggesting that respect for human rights alone in no way guarantees economic success.

If we look at aggregate figures (figure 3) the relationship is even more startling. Free countries, defined as countries with a high level of civil liberties and political rights, account for a total of 89 % of the world's GDP.²

FIGURE 3:

GDP output (US\$) by free, partly free and not free



The correlations, however, do not allow us to answer the questions: does a) respect for human rights promote economic growth, and the wealth this generates, or does b) wealth promote respect for human rights? The answer is probably both.

These were a few words on the relationship between human rights and wealth, but we also have the relationship civil liberties and political rights (= freedom) and economic freedom

2 *Freedom in the World*, New York: Freedom House, 2003.

to consider.³ Let us look at the world's most prosperous countries:

TABLE 1: Wealth, form of government, economic freedom und freedom (sum of civil liberties and political rights)

Country/GDP at purchasing power parities (current international \$)*	Form of government	Score in the index of economic freedom**	Freedom***	
Luxembourg	56,382	democracy	7.7 (1)	free
Switzerland	47,064	democracy	8.0 (1)	free
Japan	44,458	democracy	7.1 (2)	free
Denmark	38,710	democracy	7.6 (1)	free
Norway	38,298	democracy	7.1 (2)	free
Austria	33,172	democracy	7.6 (1)	free
Germany	32,813	democracy	7.3 (1)	free

3 Note that the two definitions of freedom, freedom and economic freedom, are quite separate. The *Freedom House* definition does not include economic freedom. To what extent can freedom be measured and to what extent is such measurement objective? Definitions are different as are the indicators used. Both the *Fraser Institute* (see below) and *Freedom House* are extensive and systematic in their approach to measuring freedom. *Freedom House*, for instance, uses 10 questions in a political rights checklist and 15 questions in a civil liberties checklist (see *Freedom in the World*, op. cit, section on survey methodology for details). Although we may question definitions and methodology, it is nonetheless important to try to measure freedom. The results seem to correspond with what common sense tells us (see table 1, for instance).

Table 1 (continued):

Country/GDP at purchasing power parities (current international \$)*		Form of government	Score in the index of economic freedom**	Freedom***
Finland	32,121	democracy	7.7 (1)	free
Iceland	32,060	democracy	7.6 (1)	free
Sweden	31,627	democracy	7.2 (1)	free
United States	31,592	democracy	8.3 (1)	free
Netherlands	31,333	democracy	7.8 (1)	free
Belgium	31,218	democracy	7.4 (1)	free
France	30,492	democracy	6.7 (2)	free
Ireland	29,401	democracy	8.0 (1)	free
Singapore	27,118	authoritarian democracy	8.5 (1)	partly free
Hong Kong	24,505	democracy	8.6 (1)	partly free
Australia	24,203	democracy	8.0 (1)	free
Canada	23,081	democracy	8.1 (1)	free
United Kingdom	22,697	democracy	8.2 (1)	free
Italy	21,144	democracy	7.0 (2)	free
New Zealand	18,425	democracy	8.2 (1)	free
Spain	17,595	democracy	7.0 (2)	free
Israel	16,576	democracy	6.5 (3)	free
Taiwan	15,496	democracy	7.1 (2)	free

Table 1 (continued):

Country/GDP at purchasing power parities (current international \$)*	Form of government	Score in the index of economic freedom**	Freedom***	
Cyprus	14,592	democracy	6.2 (3)	free
Greece	13,669	democracy	6.7 (2)	free
South Korea	13,502	democracy	7.1 (2)	free
Kuwait	13,345	autocracy	6.9 (2)	partly free
Portugal	13,109	democracy	7.2 (2)	free
Slovenia	11,984	democracy	6.1 (3)	free
Bahrain	11,070	autocracy	7.1 (2)	not free
Malta	10,098	democracy	6.4 (3)	free

There seems to be a clear inter-relationship between civil liberties and political rights on the one hand and economic freedom on the other, at least for economically more developed countries. The vast majority of wealthy democracies (in which political rights are widely respected) are, at the same time, countries with a high level of economic freedom.

* World Bank data for 2001; ** data for 2001 from: James Gwartney & Robert Lawson, *Economic Freedom of the World – Annual Report 2003*, Vancouver: Fraser Institute, 2003 (1 = 1st quintile (high level of economic freedom); 5 = 5th quintile (low level of economic freedom)); *** Data from: *Freedom in the World 2001–2002*, New York: Freedom House, 2002.

Economic freedom and economic and social rights

The relationships between economic freedom and *economic and social rights*, however, are the subject of greater controversy. When I refer to these rights, I mean those rights that are supposed to ensure the basics for existence and well-being (an “adequate standard of living”) and the means for so doing.⁴

The claim is often made that the implementation of economic and social rights – or second generation rights as they are sometimes called – requires a massive input of resources and that this implies, generally speaking, deliberate government intervention in the form of redistribution. This claim needs to be re-examined in the light of recent experience and in the light of a considerable amount of recent empirical research.

First: experience. Just one example, an obvious one: socialist systems with a massive amount of redistribution – reflect-

4 When I talk about economic and social rights, I have no intention of implying that they are rights in the same sense that civil and political rights are. What kind of laws would we need? If economic and social rights are enforceable by law, who would be responsible for ensuring that rulings by courts of law are enforced? How would the executive enforce such rulings and relevant laws? What would the effect of such government intervention be on the economy and, hence, on general well-being? The likely answers to all these questions imply a greater role for government in the economy. This in turn would have negative effects on economic freedom and, in the light of the evidence I will present, on growth and general well-being. I prefer to interpret such rights as being objectives, desirable objectives yes, but no more.

ed in data on income disparities – ultimately failed to meet people’s expectations, one of the major reasons why these systems collapsed. The example of the People’s Republic of China is instructive in this respect. Common-sense “socialists” abandoned their belief in a command economy many years ago and are now, step by step, dismantling their socialist legal system as demonstrated by recent intense interest in, and some steps towards establishing a judicial system that conforms with generally recognised principles of rule of law. The primacy of socialism is kept in place solely for the purpose of maintaining political power. It will be interesting to see how long this approach can last.

Second: empirical evidence. Here I wish to look at four distinct areas, the relationship between

➔ a free market and growth, assuming that growth is good for everyone⁵

5 As I will later show growth in a free market tends to benefit everyone. The reason why this should be so is reflected in an interesting comment made many years ago by Karl Popper in a magazine interview (*Der Spiegel* No. 13/1992, pp. 202–211. p. 203). “Industrialisation cannot mean impoverishment... What did capitalism mean? It meant industrialisation and mass production. Mass production means that a lot is produced and many get something – because many products need a big market and hence many consumers”. Business is only interesting and sustainable in the long term if an entrepreneur can expand and increase profits – and this involves attracting more customers, ie, increasing the number of consumers (if you produce soap it makes sense to aim for 10 million rather than one million customers). A free market has an innate tendency to try to improve the lot of more and more people because this is the only way of generating profit.

- ➔ a free market and disparities in the distribution of income
- ➔ regulation and employment, and
- ➔ the effects of taxation on employment and wealth.

Free markets and growth

Here my assumption is that, in order to promote economic and social rights, it is important to secure the foundations for so doing. It is, to use some imagery, impossible to bake a cake without ingredients and, for those who prefer to be proactive, it is not a good idea to share out a cake before it has been baked.

Recent comparative research has shown that there is a very strong relationship, I would claim an indisputable relationship, between economic liberty – the basis of a free market – and the generation of wealth.

This relationship is true however we define economic freedom. The following figure (figure 4), summarising some results from global surveys published in recent years, shows that the relationship is extremely strong. The liberal Fraser Institute, in co-operation with many liberal think-tanks throughout the world, measures a country's level of economic freedom on the basis of scores achieved in different areas affecting economic activity. In 1997 there were 17 different areas under the following major headings: a) protection of money as a store of value and medium of exchange, b) freedom to decide what is produced and consumed, c) freedom to keep what you earn and d. freedom of exchange

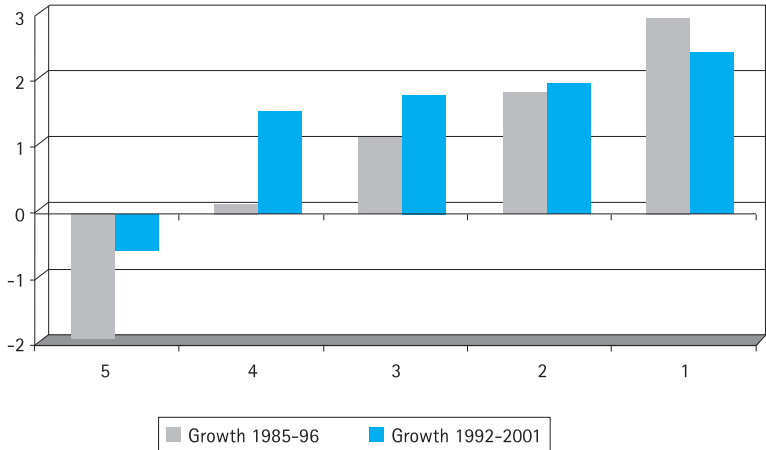
with foreigners. The index of economic freedom has been extended and refined since it was first used in the mid-1990s. Today (2003) it contains 21 components and, counting sub-components, utilizes 38 distinct pieces of data. The index now includes the level of labour market and business regulation. Refinement has led to greater emphasis being placed on the security of property rights⁶ and the rule of law. Figure 4 compares the level of economic freedom and the average annual rate of economic growth over relatively long periods for 115 countries (1997) and for 121 countries (2003) using the original and refined indices of economic freedom respectively. The countries have been divided into five quintiles, each with an equal number of countries, those with the lowest level of economic freedom being in the 5th, those with the highest in the 1st quintile.⁷ Those countries

6 To a certain extent the answer to the question whether or not economic freedom implements or promotes human rights is already answered by the way in which economic freedom is defined. The concept of economic freedom includes certain important rights, in particular the right to property and those rights closely associated with the concept of rule of law (right to equality before the law, to recognition as a person before the law, to a fair trial within a reasonable time by an independent and impartial tribunal established by law, to protection against retroactivity of law, to an effective remedy if one's rights are violated, to appeal in criminal cases, to compensation for a miscarriage of justice, all important for an environment conducive to business and entrepreneurship). A further important right is the right to freedom from exploitation (here: especially by the state!).

7 Data are from *Economic Freedom of the World*, 1997 and 2003 annual reports published by the *Fraser Institute* and liberal think-tanks throughout the world.

with the lowest level of economic liberty experienced negative growth and are today poorer than they were more than a decade ago.

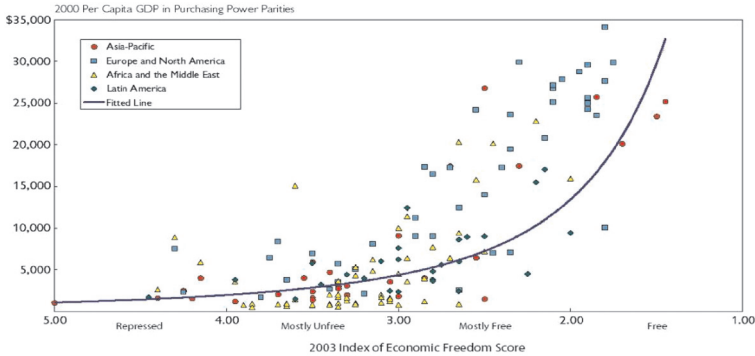
FIGURE 4: Annual average growth of GDP per capita and economic free-



That the relationship between economic freedom and growth is very strong is born out by another source, the conservative *Heritage Foundation* in co-operation with the *Wall Street Journal*. The results of their most recent comparative survey are summarised in figure 5⁸. Economic freedom is a similarly broad-based concept, the factors measured being trade policy, the fiscal burden of government, government inter-

vention in the economy, monetary policy, capital flows and foreign investment, banking, wages and prices, property rights, regulation and the black market.

FIGURE 5: Economic freedom and income



Note: Per capita GDP figures were not available for the following countries: Armenia, The Bahamas, Bahrain, Bosnia, Democratic Republic of Congo, Cuba, Djibouti, Iraq, North Korea, Kuwait, Lebanon, Libya, Malta, Oman, Qatar, Suriname, Taiwan, Tajikistan, United Arab Emirates, Yugoslavia. Per capita GDP figures are in current international dollars and are from 1999.
Source: The World Bank, 2001 *World Development Indicators on CD-ROM*.

Regional studies corroborate the findings of such global studies. A relatively recent study of the effects of market regulation⁹ on output in 11 European Union countries found that the countries with the least regulation enjoyed the highest growth in output per person, those with most regulation suffered much lower growth. The period surveyed was 1981–1993.¹⁰

9 The assumption being that more market regulation = less economic freedom.

10 Kees Koedijk & Jeroen Kremers, Market Opening, Regulation and Growth in Europe, in *Economic Policy*, October 1996.

The free market and disparities in the distribution of income

The first criticism I would expect is: “yes, there may be a strong relationship between economic freedom and growth, but this in no way guarantees that the gains are distributed in an ‘equitable’ manner”. In this connection it is fair to assume that an equitable distribution of income implies that certain economic and social rights are respected (a more equitable distribution suggests a better standard of living, more opportunities, less exploitation).

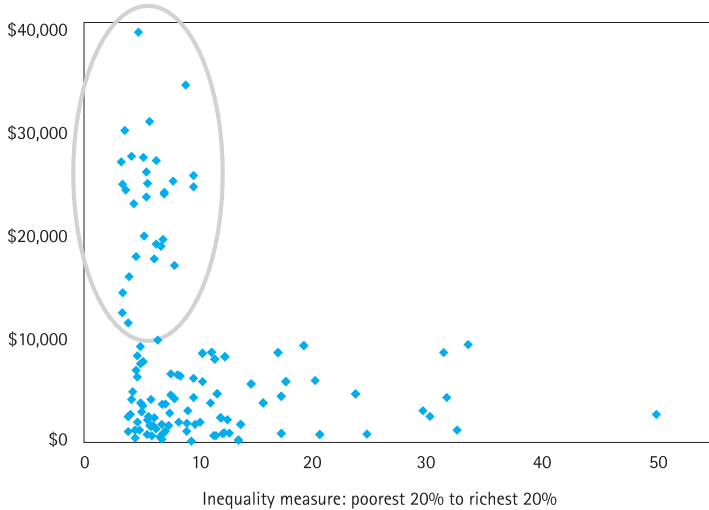
Here it is also instructive to look at the empirical evidence. Figure 6 suggests that gross national income per capita and distribution of income are closely related or, in other words: *the greater the wealth of a country, the more equitable the distribution of wealth is likely to be.*¹¹

All the countries for which the PPP estimates of GNI per capita are high (approx. \$10000 and above in figure 6) are “capitalist.” None of these countries has an income distribution ratio in excess of about 1:10. It seems as if a free market

11 The graph correlates **PPP estimates of GNI per capita** and **distribution of income** expressed in terms of the ratio of the income of the richest 20 % of the population to the poorest 20 % for those countries of the world for which the latter figures exist. For some poor countries, unfortunately, they don't. The figures are from: UNDP, *Human Development Report 2003*, Oxford: Oxford University Press, 2003, p. 282–285 (disparities) and World Bank, *World Development Report 2003* (Sustainable Development in a Dynamic World: Transforming Institutions, Growth, and Quality of Life), Oxford: Oxford University Press, 2003, p. 234–235 (GNI per capita).

economy and equitable distribution of wealth go hand in hand. This evidence is corroborated by other sources. The *Fraser Institute*, for instance, finds that income disparities between the top 10 % and bottom 10 % incomes in the countries with least economic freedom (5th quintile) are more than double those in the countries with most economic freedom.¹²

FIGURE 6: PPP estimates of gross national income (GNI) per capita and income disparities



It is interesting to note that development dictatorships such as Syria and Sudan do not publish statistics on income distribution whereas relatively open countries like the Philippines and Sri Lanka do. The self-proclaimed purpose of

12 Economic Freedom of the World 2000, op. cit., p. 17.

development dictatorships is to focus attention upon the task of alleviating the condition of the poor of their respective countries. But it is precisely such dictatorships that often choose to suppress the information by which one can measure their performance.

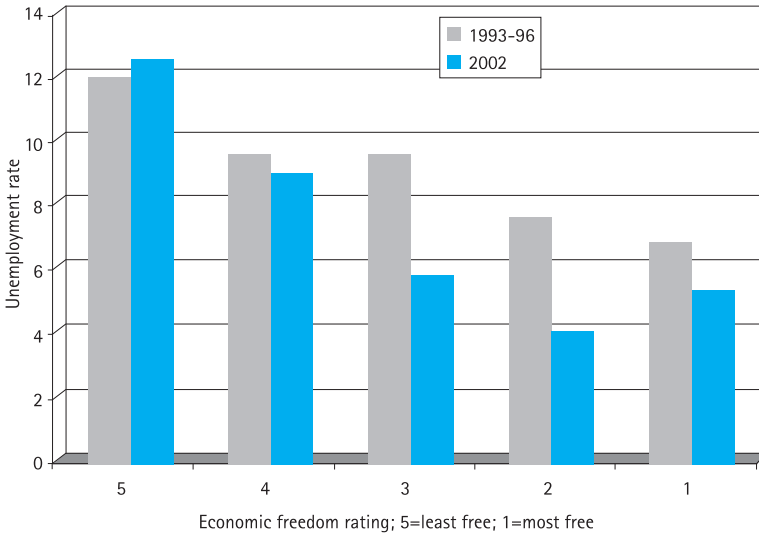
Economic freedom, regulation and employment

So far I have looked at the general relationship between economic freedom and a) growth as well as b) distribution. Let us now turn to a more specific concern: that of employment. Employment, itself considered by many to be a right, is a precondition for the realization of many economic and social objectives because employment generates income. Recent comparative research shows a very strong relationship between economic liberty and employment in the countries of the *Organisation for Economic Co-operation and Development* (OECD). For instance, unemployment is a less severe problem in OECD countries with a very high level of economic freedom than in OECD countries with a lower level of economic freedom. Evidence for 20 OECD countries shows that the unemployment rate in the quintile *least free* (5) was almost double that of the top quintile *most free* (see figure 7).¹³ More recent data for more countries give us a similar finding.¹⁴

13 Herbert G. Grubel, *Economic Freedom and Human Welfare: Some Empirical Findings*, in: *The Cato Journal*, Vol. 18, No. 2 (Autumn 1998), p. 287 ff, p. 291–292.

14 Calculations based on *Economic Freedom of the World – Annual Report 2003*, op. cit., p. 11 and OECD in Figures, 2003 edition, Paris: OECD, 2003, p. 20–21.

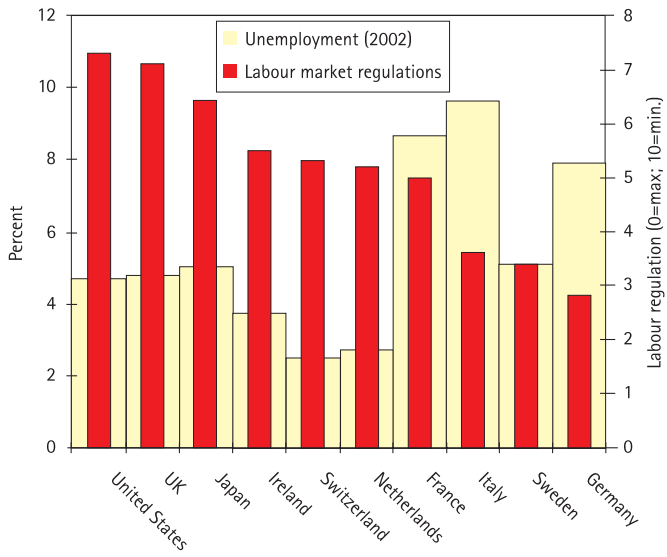
FIGURE 7: Unemployment and economic freedom rating (20 OECD countries, 1993–96, and 30 OECD countries, 2001)



As we would expect, and as comparison of OECD statistics and *Fraser Institute* scores for “labour market regulations” shows, countries with highly regulated labour markets tend to have high unemployment rates. Figure 8 compares unemployment rates and the relevant scores for countries whose economic performance is closely watched by the international community. According to the *Fraser Institute*, France, Italy, Sweden, and Germany have highly regulated labour markets and rank 41, 76, 78 and 80 out of 80.¹⁵

15 See *Economic Freedom of the World – Annual Report 2003*, op. cit., p. 14–15. More countries could not be included because of lack of relevant data.

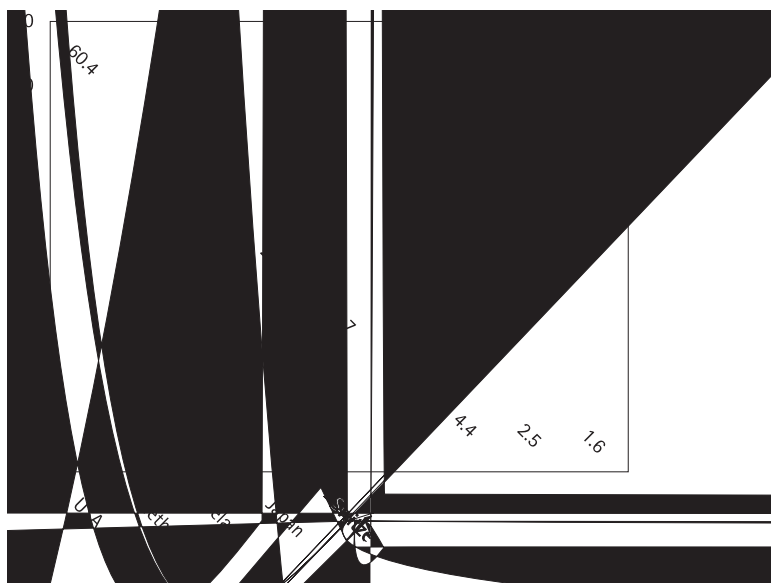
FIGURE 8: Labour market regulation and unemployment¹⁶



However, I prefer to look at total employment rather than unemployment because the latter can mask a lot of reality. To give just one important example of this problem: someone who has never had a job, but is looking for employment, is generally excluded from statistics on unemployment. More generally, if more people are employed and paid for their work, there will be less dependence on the state or on social security systems for an income. If we look at long-term figures on how well economies have been able to generate employment, we again see evidence that those coun-

16 Ibid. and OECD in *Figures*, 2003 edition, op. cit., p. 20–21.

tries with higher levels of freedom in the labour market tend to perform better than those with lower levels. The following figure (figure 9) shows long-term growth in employment. Those economies with the most flexible labour markets (ie, lower levels of labour market regulation) have, in the long term, been able to produce more jobs than their competitors. Indeed, those countries with highly regulated labour markets – Germany, Italy and Sweden – saw a very low increase of total employment in the period 1975 to 1997.



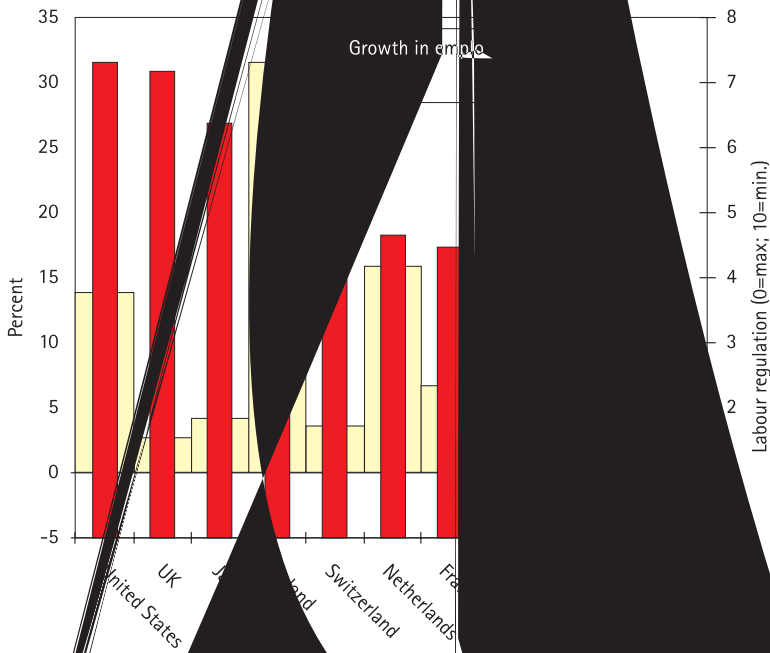
If we look at more recent figures there has been little change. Between 1991 and 2001, according to OECD statistics, the total employment in Sweden and Italy declined by 1.8 % and 2.8 % respectively. Germany's total employment increased by only 0.3 %. In the cases of Germany and Italy we might reasonably have expected higher employment growth rates because of the smaller size of their respective workforces when compared to that of the USA. Japan and Switzerland, despite the economic stagnation of recent years (average of 1.1 % growth per annum for the same period), have been able to generate employment. In stark contrast to such poor performance, total employment in one of the most liberal economies of the world, that of the USA, grew by more than 14% in the same period. The least regulated and freest economy of the European Union, that of Ireland, has seen a stunning increase of 31.6 %.¹⁸

The effects of taxation on unemployment

In the previous section we have seen that economic freedom has a positive effect on increasing total employment and decreasing unemployment. The opposite happens when labour is regulated (the more regulation of labour, the less economic freedom). Where labour is highly regulated, the effect is to increase unemployment.

The same holds true for the effects of labour taxation – where high rates reduce the level of economic freedom by

18 See OECD in Figures, 2003 edition, op. cit., p. 16–17.

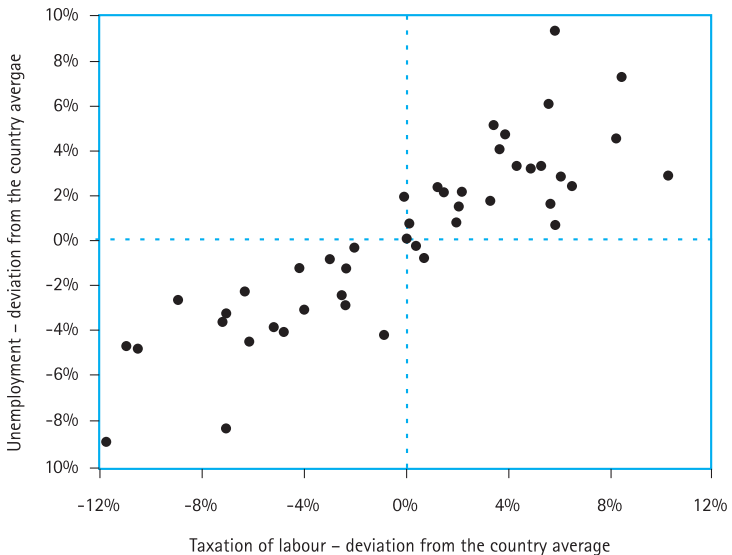


an appreciable margin. A study by the *OECD Policy Review* calculated that an observed 10 percentage point increase in unemployment rates between 1965 and 1975 could be explained by a 10 percentage point increase in unemployment of

90 per cent. As the example of the UK shows, a high level of labour market regulations (ie, a low level of such regulation) does not necessarily imply a low growth rate. In fact, the UK has a relatively high growth rate, the relationship is not necessarily linear, and we can only guess, however, how much of the increase in unemployment is due to labour market regulations and with good reason, we can only guess that the relationship would be a negative one.

roughly 4 percentage points, a reduction of the investment share of output of about 3 percentage points, and a growth slowdown of about 0.4 percentage points a year. The following figure (figure 11) from the same study shows a dramatically clear relationship between taxation of labour and unemployment (each point represents a country for a five year period between 1965 and 1995).²⁰

FIGURE 11: Taxation and unemployment in continental European countries



20 Francesco Daveri & Guido Tabellini, *Unemployment, Growth and Taxation in Industrial Countries*, in: *Economic Policy*, April 2000, pp. 49–103, p. 52. The rapid increase in labour taxation during the period studied is mainly due to rising pension expenditures.

A few conclusions:

The evidence I've presented has a number of interesting implications for liberals and human rights activists alike.

In the case of liberals, the relationships between the economic and social aspects of liberalism couldn't be clearer. Economic liberty and social concerns cannot be separated from one another. Economic freedom promotes economic and social rights. Of course, I've taken the grand view and would be the first to admit that policies promoting economic liberty can cause hardship. At the same time, however, it is important to keep the general perspective in focus. It is this general perspective that should guide overall policy. There are many reasons, some of which I've presented, to believe market-oriented policies are eventually of benefit to all.

As far as human rights activists are concerned, what could the message be? Some food for thought:

- We should not avoid dialogue with entrepreneurs, those responsible for business and economic decision-making – because of shared interests. One of these shared interests is, for instance, rule of law (a component of the concept of economic freedom). Business does not thrive in a climate of lawlessness and arbitrariness, ie, an environment in which there is no rule of law. Whether or not human rights are respected depends on the strict adherence to principles of rule of law.

- As far as economic and social rights are concerned, we should question the point and the efficacy of government intervention where this means redistribution or undermining market mechanisms. Should we demand more state intervention in order to promote economic and social rights or should we demand liberal economic policies? A lot of evidence points to the latter.
- We should ask ourselves why planning and social engineering has consistently failed to provide satisfactory results despite the persistent efforts of the well-intentioned. <http://www.lewrockwell.com/orig/136>



depressing to see how, at the same, the main issue, the material and immaterial well-being of citizens, can be side-stepped so effectively by shrouding options and the difficult decisions that need to be made in a cloud of smoke, the smoke of nationalism or class war.

The evidence suggests that respect for human rights is not an obstacle to economic freedom or to the economic growth it promotes. If it were, post-industrial economies would not consistently show a high level of respect for civil liberties and political rights (ie, a high level of freedom) and a comparatively equitable distribution of income. Finally, it is certainly not an accident that economic liberty, and the free market it implies, promotes employment.

Democracy, Freedom and Subsidiarity

*"The good of democracy is liberty, and the courage and industry
which liberty begets."¹*

The idea that democracy begets freedom and that freedom begets economic well-being is a very old one. The present chapter looks at the relationship between democracy and freedom from a liberal perspective. The next chapter will look at the links between democracy, especially liberal democracy, and economic well-being and examine some of the empirical evidence in the process.

A few introductory words on terminology

I use the terms "liberty" and "freedom" synonymously.

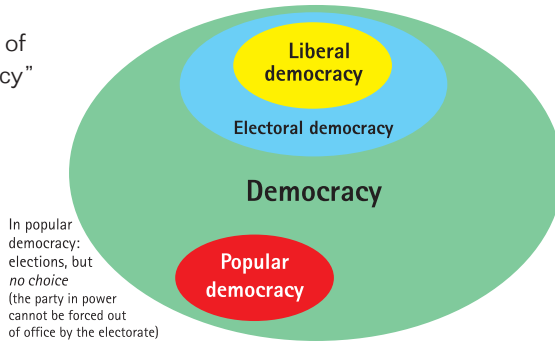
I make a clear distinction between "democracy" as a general concept and "democracy" as a term used by liberals. Here I use the term "liberal democracy" [liberal without a big

¹ *An Exact Collection of all Remonstrances, etc., between the King's Most Excellent Majesty and His High Court of Parliament, December 1641 – March 21, 1642* (London, 1643), p. 266.

“L”] rather than parliamentary or constitutional democracy, terms that we can also find in the literature on the subject. There are many other terms in use, eg, “political democracy”, terms that I will avoid. I contrast “liberal democracy” with another term coined a few years ago, “illiberal democracy.” The term “electoral democracy” is a democracy characterised by multi-party elections. But an “electoral democracy” need not be a liberal democracy. It is important to keep all these terms separate.

FIGURE 1:

Different meanings of the term “democracy”



When I use the term subsidiarity, I use it in the liberal sense of the term [which differs from the usage in the Catholic Church and differs from misrepresentation of the term in EU parlance]. The best definition, I believe, is: “Subsidiarity is a principle in social organisation. According to this principle, functions which individuals, neighbourhoods, subordinate bodies or local organisations perform effectively belong more properly to them than to a dominant central organisation.” There is some overlap between the term devolution,

commonly used by liberals, and subsidiarity. Devolution (of power) is one of the policies that will derive from commitment to the principle of subsidiarity. But the focus is a different one. The concept of devolution assumes that there is power to be devolved. The concept of subsidiarity starts at the highest level: the competence of the individual. The role of any government is a subsidiary one – assisting the individual where the individual cannot help him or herself.

The liberal attitude to democracy

A long joke, in one of its variations:

DEMOCRACY, TWO COWS AND MILK

You have two cows. In

Direct democracy	Your neighbours decide who gets the milk
Representative democracy	Your neighbours pick someone to tell you who gets the milk
Singaporean democracy	The government fines you for keeping unlicensed farm animals in an apartment
American democracy	The government promises to give you more cows if you vote for it. After the election, the president is impeached for speculating in cow futures. The press dubs the affair "Cowgate". A cow sues you for breach of contract

Italian democracy	The government doesn't know. You sell designer milk
German democracy	You have a bad conscience because the government tells you that you are too rich
British democracy	You feed them sheep's brains and they go mad. The government doesn't do anything but drinks the milk to show it's safe
French democracy	You take them to Paris, blockade the main entrance of the Ministry of Agriculture and demand more cows.
Democracy in the European Union	"The Commission." regulates what you can feed the cows and when you can milk them. Then it pays you not to milk them. After that it takes both, shoots one, milks the other and pours the milk down the drain. Then it requires you to fill out forms accounting for the missing cows

What are the lessons we learn?

Democracy's not everything. There's no perfect democracy. Democracy has its flaws and varies in its characteristics from country to country. No two democracies are the same.

More significantly, perhaps, it is by no means the cure-all solution to the problems we face. For example:

- Most decisions – including political decisions – have unforeseen effects. This also applies to decisions made by majorities. Safeguards in the form of checks and balances are hence very important in a democracy.
- Democracy per se does not protect minorities. There are two reasons for protecting minorities against majorities: the obvious one, ie, the liberal commitment to the liberty of the individual [the smallest minority] and a pragmatic one. Minorities guarantee progress. Good ideas are always ideas initially put forward by a minority, usually by a single person, the smallest minority.
- From a liberal point of view there are certain principles, principles of RULE OF LAW, and FUNDAMENTAL RIGHTS [those that constitute what we know as liberty] that may NOT be amended, even if a majority so wants. Amendment would mean fundamental change in the relationship between the state and the individual to the detriment of the latter. The end of democracy is not the promotion of arbitrary rule and no government, however legitimised, should be allowed to do whatever it likes.

Ayn Rand commented that

“Individual rights are not subject to a public vote; a majority has no right to vote away the rights of a minority; the political function of rights is precisely to protect minorities from oppression by majorities [and the smallest minority on earth is the individual]. It is bad to be oppressed by a minority, but it is worse to be oppressed by a majority. For there is a reserve of latent power in the masses which, if it is called into play, the minority

can seldom resist. But from the absolute will of an entire people there is no appeal, no redemption, no refuge but treason.”²

FIGURE 2: What is liberal democracy?



Hence, democracy for a liberal is only one aspect of an ideal political system. Other important aspects include rule of law, protection of fundamental rights, limitation of power [which means, inter alia, “small government”], and a framework promoting free and mutually beneficial interaction [free market]. When liberals talk about democracy, they talk about liberal democracy, rule by the majority seasoned or enhanced by: rule of law, regular elections and real chances for the opposition to form a government, a system of checks and balances limiting power, pluralism and strong civic institutions, a market or mixed economy as well as formal and informal conventions upholding basic rights³.

2 *The Virtue of Selfishness*, New York: The New American Library, 1964, p. 124.

Liberals support such democracy wholeheartedly, for reasons I am about to give. They do so with important conditions attached: **as long as democracy promotes freedom and does not engender tyranny**. Liberal democracy provides this assurance.

Reasons for supporting democracy

My list of reasons is not an exhaustive one. There are more. I find the following ones, however, compelling:

Reason 1:

Democracy pertains to the method of rule; liberty pertains to the objective of rule. The two are, however, inseparable. Democracy is an expression of participation and participation is an inherent part of the liberal concept of freedom. Citizens have rarely enjoyed freedom without democracy and a thriving democracy is fuelled by freedom. A part of that freedom is the right to choose one's government.

3 Despite common usage of the term, there is no standard definition of "liberal democracy." My definition includes those elements most commonly found in the abundant literature on the subject. I insist on including "market economy" as a defining element because of the difficulty of separating the political and economic spheres [Can we, for instance, find a system of checks and balances limiting power, pluralism and strong civic institutions in command economies? Do we have examples of a free press, an important check against abuse of power, where the press is "publicly owned?"].

Reason 2:

In this context it is important to remember that: Democracy is the only method of peaceful change. In the words of Friedrich August von Hayek

*"... whenever it is necessary that one of several conflicting opinions should prevail and when one would have to be made to prevail by force if need be, it is less wasteful to determine which has the stronger support by counting numbers than by fighting. Democracy is the only method of peaceful change that man has yet discovered."*⁴

In this he echoes Ludwig von Mises who stated that

*"The essence of democracy is not that everyone makes and administers laws but that lawgivers and rulers should be dependent on the people's will in such a way that they may be peaceably changed if conflict occurs."*⁵

In his characteristic way, Karl Raimund Popper makes a short-cut and connects democracy and non-violence in a very direct way:

*"The difference between a democracy and a tyranny is that under a democracy the government can be got rid of without bloodshed, in a tyranny it cannot."*⁶

4 *The Constitution of Liberty*, Chicago: Chicago University Press, 1960, p. 107.

5 *Socialism*, Indianapolis: Liberty Fund, 1981 (Liberty Classics), p. 63 (translation of the 2nd edition of „Die Gemeinwirtschaft“ published in 1932).

6 *Public Opinion and Liberal Principles*, in: *In Search of a Better World*, London: Routledge, 1994, p. 155.

Reason 3:

Democracy's biggest advantage over other forms of governance is, arguably, that it allows for alternatives. The precondition is a strong, credible and institutionalised opposition [strong in that it can attract enough votes; credible in that it can govern if elected; and institutionalised in that it is effectively protected by law and respected by the government in power].

Reason 4:

Democracy is the only feasible and satisfactory political framework for a plural society. Autocracy of any kind is per se the imposition of power by a minority ignoring the complex nature of society and the many interests existing therein. It is difficult to imagine a minority acting in line with citizens' aims and aspirations where many interests are not in a position to exert influence and participate in the decision-making process. In contrast, democracy allows us to find aggregate solutions reflecting the multitude of interests that exist in any society.

Reason 5:

Democracy, on the basis of long-term experience, seems to secure peace, and seems to be far more superior in so doing than other systems of rule. According to Rudolph J. Rummel,

"If one defines an international war as any military engagements in which 1,000 or more were killed, then 353 pairs of nations (eg, Germany vs. USSR) engaged in such wars, 1816–1991. None were between two

democracies, 155 pairs involved a democracy and a nondemocracy, and 198 involved two nondemocracies fighting each other. The average length of war between states was 35 months, average battle deaths was 15,069.”⁷

The challenge of illiberal democracy

Of course, what I have said in the previous section assumes a particular kind of democracy – and I have used the term “liberal democracy” in this connection. But we also have many countries that are nominally democratic that don’t have the qualities and advantages I have mentioned above because they do not allow for peaceful change, they do not allow for alternatives [eg, the opposition is not allowed to win], democracy does not reflect the interests in a plural society and democracy does not promote peace [eg, war between the nominally democratic Serbia and its neighbours]. These are the so-called illiberal democracies, to use a term coined by Fareed Zakaria.⁸ As he points out, we have often seen in recent years that

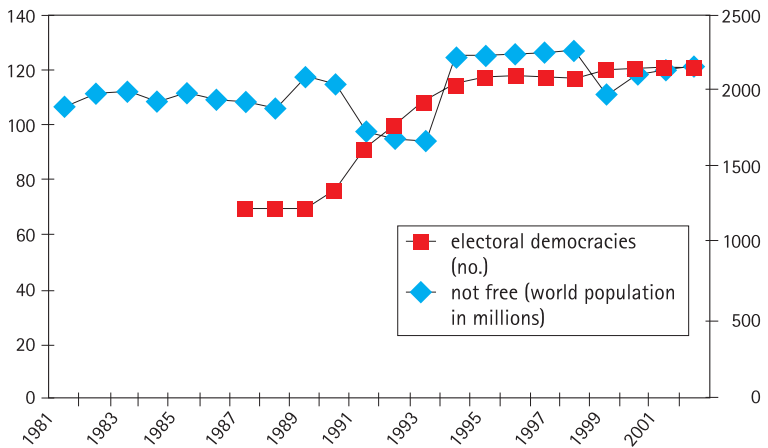
- Democracy does not prevent tyranny
- Democracy does not prevent ethnic war
- Democracy does not necessarily promote economic growth and the accumulation of wealth
- Democracy does not prevent corruption.

7 See: *Power Kills: Democracy as a Method of Nonviolence*, New Brunswick, N.J.: Transaction Publishers, 1997.

8 See below.

There are many such democracies throughout the world. This explains why, seen from a global perspective and despite rapid increase in the number of nominal democracies throughout the world, there is no perceptible decrease in the number, scale and range of human rights abuses [see following figure].⁹

FIGURE 3: Number of people in the world who are not free/number of “electoral democracies”



Source: Freedom House, various annual reports

Over the last two decades we have nonetheless been witnessing a global process in which “democracy” has become

9 Freedom House data. Freedom is understood in terms of respect for political rights and civil liberties. Where there is no respect for such rights, there is no freedom.

an accepted standard and a desirable objective of development. No politician today would publicly denounce “democracy” as a desirable method of rule. At most, a politician might claim “we are not ready for democracy yet.” However, even with such a statement, a politician is asking for trouble. The term democracy strikes a positive chord despite differences in substance. The reason the term has positive connotations lies not in the idea of “rule by the people” or “majority rule”, the two most common ideas associated with democracy, but in the expectations citizens have regarding “a good life” and the examples successful democracies represent in this respect. When a citizen of the German Democratic Republic was demanding change, he/she was demanding democracy as a means to an end: freedom and prosperity.

We have never had more democracies in the world. In terms of so-called “electoral democracies” the number is now about 120. Of course, many of these democracies are a sham, but the development is nonetheless significant.

Having said this, however, we find the idea of democracy challenged by intellectuals. A few extreme internet sites apart, one of the most radical and thoughtful standpoints has been presented by Robert D. Kaplan¹⁰, author of the two depressing and well-known books *Balkan Ghosts* and *The Ends of the Earth – A Journey to the frontiers of Anarchy*. He claims that

10 “Was Democracy Just a Moment?” in: Atlantic Monthly, December 1997, pp. 55–80.

“Modern democracy exists within a thin band of social and economic conditions, which include flexible hierarchies and allow people to move up and down the ladder... Democracy is a fraud in many countries outside this narrow band: Africans want a better life and instead have been given the right to vote. As new and intimidating forms of economic and social stratification appear in a world based increasingly on the ability to handle and analyse large quantities of information, a new politics might emerge for us, too – less like the kind envisioned by progressive reformers and more like the pragmatic hybrid regimes that are bringing prosperity to developing countries¹¹.

These sentiments echo those published in an influential article in *Foreign Affairs* by its editor, Fareed Zakaria¹²:

“...to date few illiberal democracies have matured into liberal democracies; if anything, they are moving toward heightened illiberalism. Far from being a temporary or transitional stage, it appears that many countries are settling into a form of government that mixes a substantial degree of democracy with a substantial degree of illiberalism. Just as nations across the world have become comfortable with many variations of capitalism, they could well adopt and sustain varied forms of democracy. Western liberal democracy might prove to be not the final destination on the democratic road, but just one of many possible exits...

Illiberal democracies gain legitimacy, and thus strength, from the fact that they are reasonably democratic. Conversely, the greatest danger that illiberal democracy poses – other than to its own people – is that it will discredit liberal democracy itself, casting a shadow on democratic governance.”¹³

11 Ibid., p. 80

12 “*The Rise of Illiberal Democracy*” in: *Foreign Affairs*, November/December 1997, pp. 22–43.

13 “*The Rise of Illiberal Democracy*” op. cit., pp. 24 and 42.

Their comments are part of a liberal tradition that I find unhelpful, because they fail to focus on aspirations that individual human beings share throughout the world. They exaggerate the misgivings many liberal thinkers have, misgivings that I share, concerning “democracy without safeguards” as a method. At the same time they fail to recognise the forces generating demands for democracy for what they are. One of these forces is quite definitely disillusionment with authoritarian rule. Another force we have frequently seen is economic development generated by freer markets, where market forces have been allowed to unfold.

Their concern, instead, is with effective governance and the fact that there seem to be alternatives to liberal democracy. There are a few Asian examples they might point to in favour of their argument. This view, however, is one I reject as well. In most cases, where we have seen some degree of democracy initiated, and even in cases where we have liberal democracy in place, the demand has been for more of the package in a sense liberals can identify with. This is true for Iran – where we are witnessing an ongoing struggle between conservative clerics and their supporters and more progressive forces, it is true for Turkey with a high degree of democracy, and it is true for Germany. Democracy is an ongoing process. The issues in dispute may be the right to freedom of expression (Iran); secularism or the status of cultural minorities (Turkey), extension of democratic rights in the direction of direct democracy (Germany). The struggle for democracy is a non-ending process even after the stage

of liberal democracy has been reached. I see little evidence to the contrary, and to claim that liberal democracy is a passing phenomenon or one of many possible exit points is to ignore the aspirations of the citizenry.

**The importance of the principle of subsidiarity:
freedom takes priority over democracy**

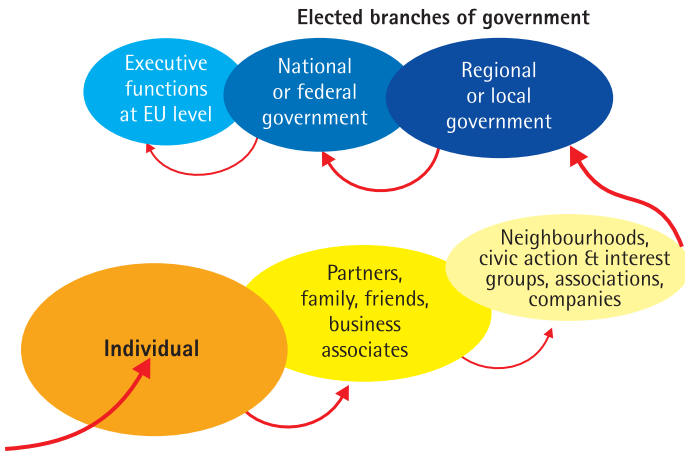
The liberal criticism of democracy does not rely on the bad examples of democracy, examples that discredit the term. Here, liberals would simply say “don’t ignore the good and useful by focusing on the bad” or, to be more colloquial “don’t throw the baby out with the bathwater.”

What is more, liberals would be inconsistent in their focus on liberty if this liberty were not to extend to the freedom to decide for oneself in the political sphere [which includes the freedom to elect one’s representatives].

The real problem liberals have with democracy is the inherent tendency we find both in developing countries and in highly developed liberal democratic systems to subject too many things to the democratic process. This is definitely the case where more than 40 % of GDP is effectively subject to collective decision-making [the government/parliament/public sector authority decides]. Almost all OECD countries fall into that category. The liberal question is the following: are we really promoting freedom if we transfer decision-making away from the individual to a collective entity, even if we do so by democracy?

these procedures guarantee participation, ie, the individual has a role to play in deciding [which is the next best thing, no more, to deciding on your own].

FIGURE 5: The principle of subsidiarity: how much should be left to higher levels?



The principle of subsidiarity implies a bottom-up approach to governance. When an individual has to delegate, he/she delegates to the next level [which might be co-operation with a friend or neighbour in order to solve a problem]. If the problem is sewage disposal, the matter might have to be delegated to a local authority. In activities with one's friends or neighbours, and in a neighbourhood, democratic procedures tend to be used, but they are usually not explicit.

Above the level of civil society, the principle asserts that functions which local government perform effectively belong

more properly to local than to central government. Democracy from a liberal point of view does not mean that everything should be subject to collective decision-making. This would make a mockery of freedom. Freedom, after all, is a condition in which “individuals decide for themselves.” Communities, or elected representatives, should only act in fields in which individuals find it impossible to act in their best interests without the co-operation of others. In such circumstances democracy ensures that individuals maintain at least some influence over decisions that are made. Having a say in decision-making, however, is not the same as deciding for oneself.

Democracy, properly understood and practised, means participation, but participation must be subject to the principle

14 I won't develop this point further, but I would like to state that the risk that individuals might make a mistake is, in most matters, an acceptable one. In the free market, we tend to accept this risk. We also assume that the overall effect of decisions made in a free market, including mistakes, is a beneficial one. The risks involved in collective decision-making are higher, partly because of a) the dimensions involved and partly because of b) human psychology. An example of a): The German post-war decision to introduce a pay-as-you-go pensions system is now widely regarded to be a costly mistake, a mistake governments find almost impossible to correct. An example of b): you are forced by law to pay high contributions to a medical insurance scheme. You will try to get as much out of the system as you can. The net effect will be to make the system even more expensive. The effects of the surrender of autonomy inherent in the provision of public goods are described in Anthony de Jasay, *Social Contract, Free Ride – A Study of the Public Goods Problem*, Oxford: Clarendon Press, 1989.

of subsidiarity – meaning that decisions should always be made at the lowest possible level. Where individuals can fend for themselves – and they are perfectly capable of so doing in most aspects of life – others, including governments, should not interfere.¹⁵ Interference always involves coercion, costs money and destroys structures of self-help and civil society. Anthony de Jasay made a very pertinent observation in this respect:

“democratically reached collective decisions usually aim at eroding privilege, levelling out rewards and making the more widely accepted notions of fairness prevail over less popular principles in the distribution of burdens and benefits. Under a democratic decision rule, all those who count, count equally in the common decision, regardless of their different possessions, abilities, and concerns. Each can better his chances of attaining his preferred state of affairs by using collective decisions for committing the resources and energies of others to the uses he prefers; yet none can afford to let others do this to him without trying to do it to them.

Whether the result is sheer inconclusive churning or whether a majority succeeds to bend collective outcomes in its own favour, the attempt by each either to reap free-rider gains or to protect himself from the like attempts of others acts to broaden the scope of collective resource allocation.¹⁶

15 This principle can also be applied to reform current systems of social security. For an example of consistent application of the liberal principle of subsidiarity to social policy, see the recent discussion paper published in German by the Liberal Institute of the *Friedrich-Naumann-Stiftung* in Potsdam, Germany. It is entitled „*Grundsätze liberaler Sozialpolitik – 12 Thesen*“ and is available on the Foundation’s website under <http://fnst.de/libinst/umdenken/12thesen/thesen.phtml>. An English translation, *Basic Principles of Liberal Social Policy – 12 Propositions*, is also available.

16 *Social Contract...*, op. cit., p. 7

Democratic decisions may be necessary, but not as often as most of our contemporaries think, and costs are involved, not only in terms of liberty, but also in terms of fairness and efficiency. Democracy, as de Jasay observes, is insatiable. A diet is good for its health.

The challenge

The challenge for liberals in the political sphere is – and has always been – to make democracy work for the benefit of citizens and individuals, their freedom and their material well-being. If citizens and their wishes are taken seriously, there is no alternative to liberal democracy and the pluralism it reflects and supports. This means a number of things:

1. **Liberal involvement in politics.** This is perhaps too obvious a statement, but it needs to be said.
2. **Real and viable political alternatives** [eg, through viable liberal policy alternatives, political organisation and effective campaigning].
3. **Commitment to democracy** – understood in the sense described above – which is only real and meaningful from a liberal point of view if those in positions of power
 - a. are prepared to organise free and fair elections
 - b. concede defeat if the electorate so decides and
 - c. hand over power to the opposition in that eventuality.

- d. Liberals campaigning for democracy should focus on developing a culture of accepting an essential role for opposition, including accession to power.
4. **Avoid the mistake of too much reliance on** democracy or, referring to the same idea from another angle, **frugal use of democracy**. Democracy is not a cure-all solution. It is a way of doing things when collective action is necessary. Liberals should always focus on freedom first. This means freedom by the individual to decide for him or herself. Before issues are resolved by higher authorities or by law, liberals should ask themselves critically whether these issues warrant attention [even if this attention is by democratically elected bodies].
 5. **Focusing on freedom means taking the principle of subsidiarity seriously.**
 6. **Ensure that government neither becomes too powerful, nor too bureaucratic, nor overstretches its capacity to do useful things.** Citizens' initiative must be encouraged, not discouraged! What liberals want is a civil society in which citizens organise and run their own affairs, leaving only those tasks to government that manifestly they cannot fulfil.
 7. **Commitment to the rule of law; the rights of individuals and minorities and to a free market in goods and ideas** as over-riding principles governing all social interaction. Democracy has, in principle, been accepted throughout the world. In those countries in which democracy has

been established, the main task now is to focus on and promote liberty itself.

8. **Readiness to further develop democracy** in the realisation that we have different stages of democracy and that democracy is an ongoing process. Where participation is required, there is much to be said for enhanced participation.

Is democracy good for growth and growth good for democracy?

Problems of defining democracy

We have already seen that growth and prosperity on the one hand and freedom and human rights on the other are inter-related. Can the same be said for growth and democracy?

The link between human rights and freedom is a clear one: there is no freedom without rights. Unfortunately, although the terms human rights, freedom and democracy are often used interchangeably, the link between freedom and democracy is not. Political freedom requires democracy – but we have many democracies in which freedom is limited. Iranian democracy is a good example of this latter phenomenon. Such democracies are now commonly called illiberal democracies, democracies in which rights are massively curtailed.¹

Exercising one's political rights in a democracy, especially that of participating in political decision-making, can lead to the suppression of minorities by majorities or the complete abolition of rights. Minorities face problems in Greece and

1 See previous chapter.

Turkey because they are not recognised as national or ethnic minorities. The right to property does not have constitutional status in the democracies of India and Sri Lanka. The right to free expression does not exist in Iran. In such democracies basic pillars of freedom are not in place².

The liberal understanding of democracy

It is because of such experience that liberals insist that democracy not only provides for participation in the political process but also guarantees that such participation will lead to promotion and consolidation of freedom. This means, among other things, respect for human rights. It also means institutions and conventions that protect such rights in a robust manner.

Thus, when liberals define democracy, they go beyond the term's basic meaning which is rule by the people³. They go beyond refinements – with which they would agree. The most thorough is that by Robert A. Dahl:

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- 2 The tension between freedom and democracy is a classical liberal concern. Most liberals put freedom first, pointing out that freedom is an objective and democracy more a method by which to achieve that objective. This doesn't mean that democracy is unimportant – but it does mean that liberals object to particular kinds of democracy (“illiberal democracy”, for example). Important texts on this subject are: Friedrich A. von Hayek, *The Constitution of Liberty*, chapter 8 (Majority Rule), Chicago: University of Chicago Press, 1960, p. 103 ff and Fareed Zakaria, *The Rise of Illiberal Democracy*, op. cit., p. 22 ff.
 - 3 The origins being the Greek words *demos*, *the people*, and *kratos*, to rule.

“Democracy provides opportunities for

1. Effective participation,
2. Equality in voting,
3. Gaining enlightened understanding
4. Exercising final control over the agenda
5. Inclusion of adults.”⁴

Liberals take a further step and understand democracy as liberal democracy, ie, as democracy plus a number of other characteristics, rule of law being an essential such characteristic.⁵ That is, democracy is seen as a method of government in the general context of freedom and as an expression of freedom in the political sphere. The latter is so important because freedom would not be complete without political participation. So, when the term democracy is being used, it should not come as a surprise that often liberals are in fact talking about freedom and the institutions that protect freedom⁶.

It would hardly be worth struggling for democracy if it were otherwise. Democracy means, for most people, realising their rights to full political participation and a host of other

4 In: *On Democracy*, New Haven: Yale University Press, p. 38. Effective participation refers to opportunities to make views known before a policy is adopted. Enlightened understanding means that there must be equal and effective opportunities for learning about alternatives and their like consequences (see p. 37).

5 See previous chapter for a brief definition of liberal democracy.

things. East Germans in the late 1990s, demonstrating for democracy and chanting „Wir sind das Volk“ (we are the people), demanded a package: political participation, accountability, an end to fear and comprehensive surveillance by the secret police, freedom to express ideas and opinions and a better standard of living. Approaches and definitions of democracy that take such considerations into account are in accordance with liberal ideals.

Measuring democracy

When democracy is measured, many experts on the subject proceed to measure liberal democracy and exclude “illiberal democracies.” The freedom index developed by *Freedom House*, based on aggregate scores for political rights and civil

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- 6 The tension between the two was discussed in the previous chapter. When liberals are confronted with the choice *freedom or democracy* the decision must be freedom – in accordance with the maxim “freedom first”. The purpose of democracy cannot be to vote in favour of eliminating other people’s freedom. However, there is another level to this issue: When decisions are reached using democratic means, those that have lost the vote must accept the outcome even though it is not the outcome they wanted. Democratic decisions are by nature collective decisions. After the decision has been made, the individual is no longer free to decide for him or herself. This amounts to a restriction of freedom. This is the reason why liberals support the principle of subsidiarity. Decisions are left to the smallest unit, the individual, wherever and whenever possible. This is what freedom in its real sense requires. Democracy is a backup in that it provides for participation in those cases in which the best solution seen in terms of maximum freedom, the freedom of each and every individual to do his/her thing, is impossible.

liberties, is often used as a measure for democracy. The practice is legitimate because it contains many – if not most – components that are important for a liberal understanding of democracy. Furthermore, all countries categorised as being free are, at the same time, liberal democracies. What is more, use of the freedom index excludes the possibility of over-rating democracies with regular parliamentary elections but without a democratic culture in the liberal sense of the term.

In this chapter I will examine the links between prosperity and democracy more closely. In doing so, I will use the term democracy in its more basic sense, unless I state otherwise. One of these measures has again been developed by Freedom House. Democracy is defined in terms of what it calls “electoral democracy”, a political system:

“... whose leaders are elected in competitive multi-party and multi-candidate processes in which opposition parties have a legitimate chance of attaining power or participating in power.”⁷

The number of electoral democracies is much bigger than the number of “free” countries because of the poor human rights records of some electoral democracies.

The advantage of using a more narrow definition of democracy is that it helps us focus more on political participation rather than freedom in its wider sense.

7 *Democracy's Century: a survey of global political change in the 20th century*, New York: Freedom House, 2000, p. 1.

The importance of discussing links between democracy and wealth

Why is this discussion so important? It is important because of the widespread belief that democracy is bad for the economy. For instance:

- Authoritarian regimes in parts of the developing world defend their actions arguing that
 - development needs a firm hand,
 - democracy leads to chaos and undermines development
 - democracy is a luxury that only the relatively wealthy can afford
 - if poor people are given the choice between democracy and fulfilling economic needs, they would choose the latter
 - democracy reflects “western” values and priorities.⁸

8 For a full discussion of such criticisms and a refutation, see: Amartya Sen, *Development as Freedom*, New York: Anchor Books, 1999, chapter 6 (The importance of democracy), p. 147–159 and, with respect to “western” values, p. 227–248. Sen argues that political and economic participation is important in itself for all human beings, irrespective of culture. He then goes on to emphasise the links between the two, saying that they “are not only instrumental (political freedoms can have a major role in providing incentives and information in the solution of acute economic needs), but also constructive. Our conceptualisation of economic needs depends crucially on open public debates and discussions, the guaranteeing of which requires insistence on basic political liberty...” (p. 147–148).

- Many experts in the developed world contend that democracy tends to lead to more intervention in the economy and undermine free markets. The less free markets are, the lower growth rates will be.

There is also a widespread belief among politicians and social activists, particularly those that campaign against so-called globalisation, that the economy left to itself or economic laissez faire will lead to a widening of disparities between rich and poor. Only the “fittest” will benefit. This is why we need democracy: to correct the negative effects of free markets.

This latter belief will be left to the penultimate chapter of this book to discuss.

The economic reasons for democracy

The last wave of transition to democracy in the 20th century, towards the end of the 1980s/beginning of the 1990s, was characterised by demands for a higher standard of living, participation and freedom. Communist regimes with nothing to offer collapsed. The so-called velvet revolution, a revolution with little or no loss of life, was considered a liberal revolution and a triumph of liberalism. Today we tend to forget the euphoria of the time⁹.

The process differed from country to country, but there are common factors that I would like to emphasise:

- There was no single reason left for supporting totalitarian or autocratic regimes. Waiting for the fruits of one’s labour

whilst others were racing ahead was no longer an acceptable option. Material expectations could no longer be met and standards of living were in sharp decline compared with those of the west;¹⁰

- A substantial number of people who gave discontent a political voice existed in most countries. Economic discontent or disenchantment was accompanied by a parallel and determined demand for political participation (democracy) and freedom;
- No distinction was made between economic and political demands. Indeed, the reason for economic decline was

9 The best-known book expressing the euphoria of the time is Francis Fukuyama's *The End of History and the Last Man*, London: Hamish Hamilton, 1992. The demands for liberty and prosperity are liberal demands and the successful revolutions represent a final coming of age for liberalism and its agenda. There are no viable alternatives and we have reached the end of history – at least according to Fukuyama. Today, with the globalisation of terrorism and the conservative backlash, few would share such deterministic views.

10 Economic stagnation coupled with the knowledge that people are much better off in the capitalist west fuelled discontent in central and eastern Europe. The mass support for democracy in this part of the world, and in others as well, is in part explained by economic motives. Fukuyama writes: "The enormously productive and dynamic economic world created by advancing technology and the rational organisation of labour has a tremendous homogenising power... The attractive power of this world creates a very strong *predisposition* for all human societies to participate in it, while success in this participation requires the adoption of the principles of economic liberalism. This is the ultimate victory of the VCR" (*The End of History*, op. cit., p. 108).

seen to be political. It was inherent in the political system. The command economy was an institution that could only be pushed aside by replacing the political elite.

Finally, there was a common external factor: the end of the cold war and the systemic competition between west and east caused by political changes within the Soviet Union.

- The likelihood that the Soviet Union would intervene in neighbouring countries and re-establish the status quo ante was remote compared to previous periods.

It is clear that one of the major factors generating a demand for democracy and promoting democratisation was economic discontent. This, however, also means that the success of democracy will be judged by the extent to which democracy can deliver the goods and, more specifically, the economic goods.

The ultimate success of democratisation is itself in doubt if there is no consensus on the need for radical economic reform as was the case in Russia and Ukraine immediately after their independence. Democratisation must thus be accompanied by economic reform. Democracies that go through extreme economic crises and experience declining living standards have in the past been easy prey for enemies of democracies and freedom. There's no reason why this should not continue to be the case.

The following links between democracy and prosperity are thus apparent. The demand for prosperity is often linked to

the demand for democracy. Citizens perceive democracy to be an alternative that can provide prosperity where non-democracies have failed. Failure to provide prosperity is likely to have negative repercussions on democracy.

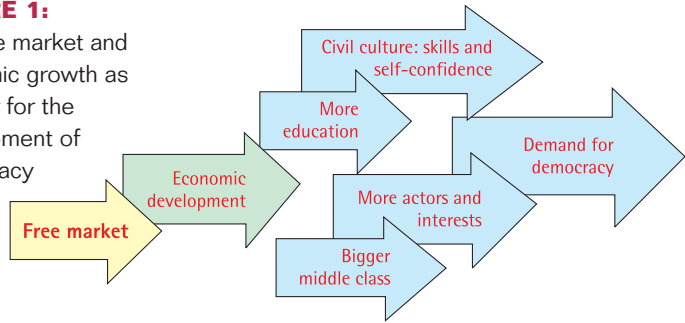
Demand for democracy as an outcome of economic growth and prosperity

A paradox perhaps, given what has been said so far, is the fact that successful economic development – not only economic failure – can spark off a process of democratisation. To mention two examples, perhaps extreme ones: Chile and South Korea¹¹. Both states have experienced military rule and both pursued policies that were broadly market-oriented during the period of military dictatorship.¹² High growth rates and considerable economic development were the outcome. This in turn gave rise to demands for democracy or its reintroduction. The process is a complicated one, but its essentials can be summarised as follows:¹³

11 Further examples are Thailand and Turkey. For a detailed discussion of the links between economic reform and democratisation in such countries see: Stephen Haggard & Steven B. Webb, *Voting for Reform: Democracy, Political Liberalisation, and Economic Adjustment*, New York: Oxford University Press, 1994. It is interesting to note that in all cases the success of economic policy did not lead to weaker demand for democracy. Whether or not democratically elected successor governments are as successful in their economic policies is no longer a matter of dispute, given the time they have spent in power. One should always remember in this connection that elected governments have pressure groups and their powers of mobilisation, themselves a feature of democracy, to deal with.

FIGURE 1:

The free market and economic growth as a motor for the development of democracy



The individual steps in this process require a little explanation:

- We have already shown that free markets generate sustained high levels of growth, the higher the level of economic freedom, the greater the growth.

-
- 12 Such exceptions aside, there are few examples of dictatorships that are successful in economic policy and very few examples of dictators that are pro-market in orientation. The run-of-the-mill dictator promotes and cements the structures that his clients thrive on and tries to use the state to drive the economy. Most dictatorships have failed because of their economic incompetence.
 - 13 The process outlined in the diagram is similar to the one described by Samuel P. Huntington in *The Third Wave – Democratisation in the Late Twentieth Century*, Norman: University of Oklahoma Press, 1991, S. 59–72 (diagram on p. 69). He outlines further reasons for democratisation in this period including the increasing prevalence of democratic norms; the lack of success of such regimes in the economic sphere; a change in the policies of the Catholic Church vis-à-vis authoritarian regimes; and snowballing effects – whereby the emergence of democratic regimes in one country would strengthen movements for democracy in other countries.

Economic growth produces the following effects:

- The resources available for education increase with growth.

Where this is not the case, countries risk poorer economic performance later on. Most governments are well aware of the link. Investment in education, whether private or public, is investment for the future, human investment to meet the demands of a more advanced economy.

Many parents, irrespective of the culture they have been brought up in, invest heavily in the education of their children once they have secured their basic needs.

- The number of citizens belonging to the so-called middle classes and for whom political participation is important for economic reasons rises with economic growth.

Typical professional groups considered to be part of the middle class – teachers, lawyers, doctors, engineers, artists, businessmen and women, civil servants, to mention but a few examples – tend to become more active politically as salaries and know how increase. Their prime aims are to protect gains against arbitrary rule and to improve their professional and personal prospects. Stable conditions, including predictability and rigorous protection of rights, are of particular importance for journalists, lawyers and small and medium entrepreneurs.

- The number of companies grows as the economy grows and hence the number of actors with an interest in busi-

ness-friendly policies. They demand greater participation, either directly or through interest groups and lobbies, in decision-making affecting their economic interests.

- Well-educated citizens are less likely to accept “what fate has ordained” or their “God-given” lot and more likely to question established practices and traditions.

Educated citizens are more self-confident and prepared to assume responsibilities and more sceptical of the wisdom and abilities of the authorities in charge.

- Economic growth opens up new horizons and gives rise to greater expectations.

Step by step the wealth that comes with economic growth liberates citizens from the burden of struggling to survive and eke out a meagre living. Resources can be set aside for purposes other than meeting basic needs: for education and for access to the media, for example. Such things are a gateway to the world and part of reality in many developing countries. They contribute to the worldwide “revolution of rising expectations”, expectations that are not only material, but also political in kind.

Indonesia is a good example of the way in which the various factors of the matrix described above interact: democracy in accordance with the principles of *Pancasila* was little more than a system protecting the nepotism of a small civilian and military elite from competition and criticism. In the long run, this elite was not in a position to ward off insistent demands

for greater democracy, a demand that grew as the economy grew. With the onset of economic crisis, the demand for more democracy was augmented by demands for economic reform – thus accelerating the demise of the old order.

A similar explanation of what happens with economic growth is based on the idea that through bringing wealth to people it also increases their power. Wealth can be used to exert influence and hence power. A citizen invests in something he/she chooses. That same person buys one paper rather than another or pays a subscription to a particular party and not another. A lawyer can be paid to contest a case in court. In this sense wealth is a power resource. With money, if need be, a citizen can buy a weapon. Growth brings dispersal of such power resources because growth is rarely the outcome of the entrepreneurial activities of a small handful of people. The higher the level of wealth, the more widespread the distribution of power resources. That the dispersal of power resources should lead to democratisation is only to be expected. Beyond a certain point, when wealth is widespread, an individual or a small group can no longer amass enough power to maintain its hegemony over other groups in society. It can no longer exclude other groups with similar resources at their disposal from power. The arrangement that emerges from the stalemate is the sharing of influence and power institutionalised in the form of democracy¹⁴.

14 See Tatu Vanhanen, *The Process of Democratisation – A Comparative Study of 147 States, 1980–88*, New York: Crane Russak, 1990, on this subject.

Do such arguments hold in all cases? Does growth, once a certain threshold has been crossed, generate a demand for democracy? Will elites accept the need to share power? Perhaps not – but we have already seen that there are very few wealthy undemocratic countries. The answer “no” is unlikely in the long run. The wealthiest countries of the world are all democratic. Totalitarian and authoritarian states with good economic records, of which there are few, might be in a position to suppress demands for democracy for a time. An example of this is the Tienanmen Square massacre in Beijing on 4 June 1989. Here it is interesting to note how much China has changed since. Totalitarianism has in general become a phenomenon of the past¹⁵.

An economic threshold for democratisation?

The fifteen years between 1974 and 1989 saw an enormous surge in democratisation¹⁶:

The above table seems to suggest that the wealthier a country is, the greater the likelihood of democratisation. A high growth rate – or stagnation, as explained above – does not in itself lead to democratisation. There seems to be an

15 North Korea is one of a few exceptions. Whether or not new religious “fundamentalism” can give rise to a new variety of totalitarianism remains to be seen.

16 Table from: Huntington, *op. cit.*, p. 62, slightly adapted. The author uses a “procedural” definition of democracy.

economic threshold below which the probability that democratisation will take place is relatively low. This is what we would expect of countries with a small formal sector and in which most economic activity is at the level of subsistence.

TABLE 1: Economic development and democratisation

GNP per capita in US\$ (1976)	Democracies in 1974	Democratisation 1974–89: number of countries	Remaining autocracies 1989	Total	Percentage of countries that have undergone democratisation*
<250	1	2	31	34	6 %
250–1000	3	11	27	41	29 %
1000–3000	5	16	5	26	76 %
>3000	18	2	3	23	40 %
Total	27	31	66	124	32 %

The threshold argument seems to be weaker for the 1990s, a decade in which we saw a large number of poor countries becoming democracies. I would venture to guess that this is not so much a result of mounting pressure for democratisation, which no doubt exists in such countries as much as it does in other parts of the world, but a lack of perceived alternatives to democracy in the face of the collapse of socialism and the dismal performance of development dictatorships.

* As a percentage of the number of autocracies in 1974; only countries with more than one million inhabitants are included.

Sustaining democracy through growth

The implicit assumption underlying demands for democracy that emerge either as a result of a) economic frustration or b) economic progress is that democracy is effective in dealing with economic problems. This is a challenge that democracy cannot afford to ignore. Democratisation is not an irreversible process and “What we need are ways to preserve the benefits of democracy without letting popular forces destroy the economy that supports them.”¹⁷ The most important way is through economic policy. Luckily, a) democracy and growth often complement each other, as we will see later on and b) there is no a priori evidence that the more democracy there is, the less beneficial for the economy.

But before proceeding I would like to note that democracy, once it has been established, seems to be very resilient. The new democracies of central Europe, the new and candidate members of the European Union in particular, seem to be very resilient despite varying economic fortunes. Democracy seems to be a value in itself and highly prized even when economic performance is meagre. India and Sri Lanka are examples of countries with a long tradition of democracy where economic problems, mass poverty and civil strife have not given rise to substantial anti-democratic sentiment.

17 Lawrence H. Summers in: *Voting for Reform*, op. cit., p. xii.

Does democracy promote or discourage growth?

What is the evidence for democracy itself producing good economic results?

Just as other systems of rule democracy has the potential of undermining growth. The reasons, however, are different. For instance, majority decisions in a legislative body to redistribute income or to regulate industry and commerce can discourage investment and undermine growth. A rapid succession of amendments to legislation can undermine business confidence. Strong lobbies may be able to persuade legislators to favour their clients and discriminate against less well-organised actors – with dire consequences for the economy as a whole¹⁸.

The widely accepted view that democracy must be bought at the expense of economic performance must, however, be treated with some scepticism.

18 Robert J. Barro in chapter 1 of *Getting It Right – Markets and Choices in a Free Society* (Cambridge, Mass.: MIT Press, 1996, summarises some of the effects democracy can have on economic performance, including the ones mentioned. He concludes that “analysis shows that improvements in the standard of living... substantially raise the probability that political institutions will become more democratic over time. Hence, political freedom emerges as a sort of luxury good. Rich places consume more democracy because this good is desirable for its own sake and even though the increased political freedom may have a small adverse effect on growth. Basically, rich countries can afford the reduced rate of economic progress” (p. 11).

There is no visible evidence supporting the proposition that authoritarian regimes will by nature tend to produce better growth rates than their democratic competitors. To the contrary: most authoritarian regimes have failed in this respect. There are some problematical exceptions, particularly in south and south-east Asia, if one is prepared to describe all states in question as authoritarian¹⁹. Nonetheless, many economically successful states in the region are parliamentary democracies, at least in the formal sense of the term, have stable institutions, eg, a relatively independent judiciary and tolerate very active and critical interest groups. In the eyes of two critical observers who call the countries in question “semi-democratic nations”, they “have more effective institutions than do the authoritarian nations. In the latter a single institution (for example, the Communist Party of Vietnam or the *State Law and Order Restoration Council* of Burma) operates without checks and limits. There is nothing to prevent these governments from pursuing disastrous policies.”²⁰

The former command economies of central and eastern Europe and Asia can point to periods of high growth gener-

19 In this respect it is also important to find out how people in the region see things. The former prime minister of Malaysia, Mahathir Mohamad, has the following relevant observation to make: “When Malaysia became independent in 1957, our per capita income was lower than that of Haiti. Haiti did not take the path to democracy. We did. Now Haiti is the poorest country of the Americas. We could not have achieved what we achieved without democracy” (cited in: John Naisbitt, *Megatrends Asia*, London: Nicholas Brealey Publishing, 1996, p.112).

ated by forced industrialisation. Growth rates were, for a time, impressive, but an economy based on heavy industry proved eventually not to be enough for sustained development. Opinions are divided on when economic stagnation and decline began. The relevant observation in this context is, however, that these systems collapsed and no longer exist.

There are democracies that pursue bad economic policies. However, the root of the problem is not democracy per se. India is an important example in this respect, a country with an almost continuous history of democracy since independence in 1947.²¹ A typical argument is that intense democratic participation, coupled with government policies hostile to business, prevent ordinary Indians from reaping the benefits of scientific and technological progress. Effective and successful lobbying has led to extremely high levels of regulation, subsidies and protection against foreign competition. Nationalism, for a long time, prevented opening of

20 Clark D. Neher & Ross Marlay, *Democracy and Development in Southeast Asia*, Boulder, Col.: Westview Press, 1995, p. 200–201. The authors contend that it is misleading to talk of authoritarian government in many cases and prefer to use the term “Asian democracy” instead. They contend that these systems, given sufficient public pressure, have the potential of developing into liberal democracies. Of course, it is true that there is “strong government” or “leadership” and that it has sometimes happened to produce good economic policy. Using this line of argument, the same leadership was also responsible for the recent economic crisis that beset the region.

21 That is, excepting 15 months of emergency rule.

domestic markets for foreign investment. Per capita income has increased at a slow pace when compared to that of South Korea or Malaysia.²² The aggregate figures, however, mask what is happening underneath. Economic performance differs from state to state. The south Indian metropolis Bangalore, for instance, has become the leading location for high tech in the country and enjoys very high growth rates. In the field of software development India has become a world leader. A democracy can produce bad economic policy – but it can also do the opposite!

What about democracy and growth in well-established democracies? Perhaps surprisingly, long-term growth rates in the second half of the 20th century never returned to the lower averages predating 1950. The following table shows long-term averages for 16 OECD countries. The countries are highly developed both in economic terms and in terms of democracy. The average annual growth rate for the 40 years between 1950 and 1990 was substantially higher than average for the whole period between 1870 und 1990, 1.9 %. The period between 1930 and 1950 saw the ascendancy of fascism in some of the countries concerned and the second world war. Immediately after this period this group of countries saw an unprecedented average growth rate of 3.7 % per annum, a period in which all countries concerned were fully fledged democracies.

22 See Bernard Imhasly, *Ist die Demokratie verantwortlich für Indiens bleibende Armut?* in: *Neue Zürcher Zeitung*, 28/29 September 1997, p. 37).

TABLE 2: Long-term growth averages for 16 OECD countries

Period	Average growth in % per year	Number of countries
1870–1890	1.2	13
1890–1910	1.5	14
1910–1930	1.3	16
1930–1950	1.4	16
1950–1970	3.7	16
1970–1990	2.2	16

Source: Robert J. Barro & Xavier Sala-i-Martin, *Economic Growth*, New York: McGraw-Hill, 1995, S. 6 und S. 364–366. The countries covered are Australia, Belgium, Denmark, Germany (West), Finland, France, UK, Italy, Japan, Canada, Netherlands, Norway, Austria, Sweden, Switzerland and USA.

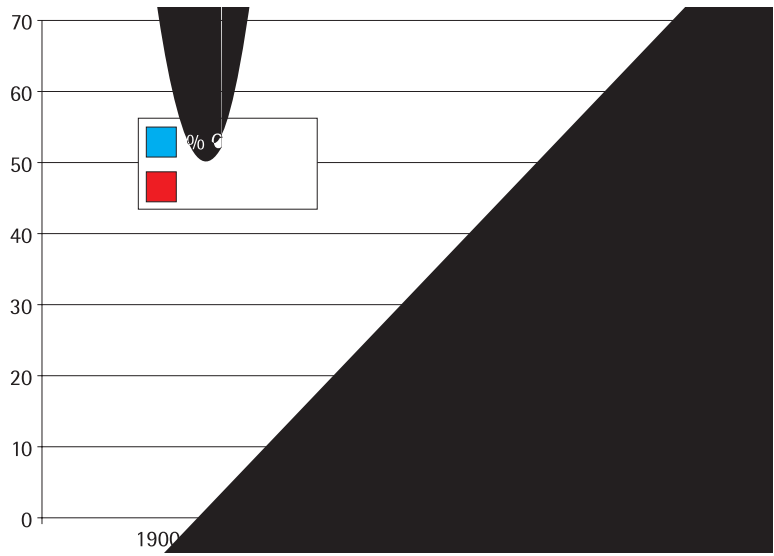
The lower average growth rate in the following two decades (1970–1990), perhaps the result of slower growth in productivity, is still much higher than the long-term average. Growth in the 1990s showed no sign of decline, compared with the two previous decades. In the OECD as a whole growth averaged 2.6 % per annum in the period 1992 to 2001, the United States as the world's largest economy 3.4 % for the period 1991 to 2001²³.

Such growth rates demonstrate that high levels of democracy do not automatically entail lower growth rates. If this were the case, growth rates in earlier periods when democ-

23 *OECD in Figures: statistics on the member countries*, Paris, 2002 (OECD Observer 2002/Supplement 1), p. 14.

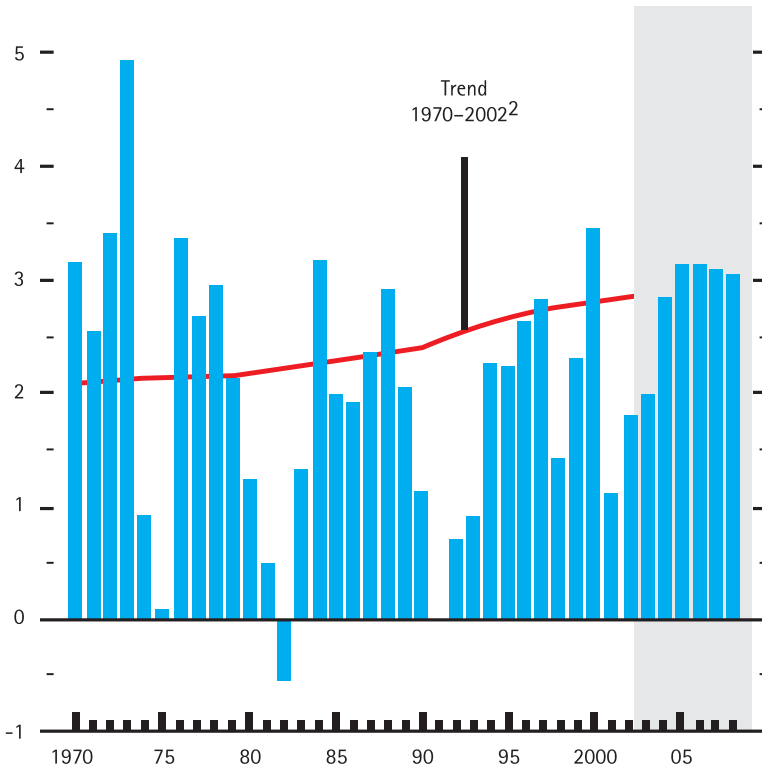
racy was less fully developed would have been higher. Indeed, the statistical evidence shows that the highest average growth rates coincide with a maturing of democracy.

What is the evidence for a link between democracy and growth at a global level? The increase in the number of electoral democracies increased from 22 in 1950 to 119 in 2000. In percentage terms, almost 60 % of the world's population lives in a democracy and over 60 % of the world's countries are democracies.²⁴



The long-term trend for growth in world per capita GDP is an upward one – slowly approaching 3 % (see figure 3). World-wide democratisation and improved performance of the world economy seems to be taking place hand in hand.

FIGURE 3: World real per capita GDP²⁵



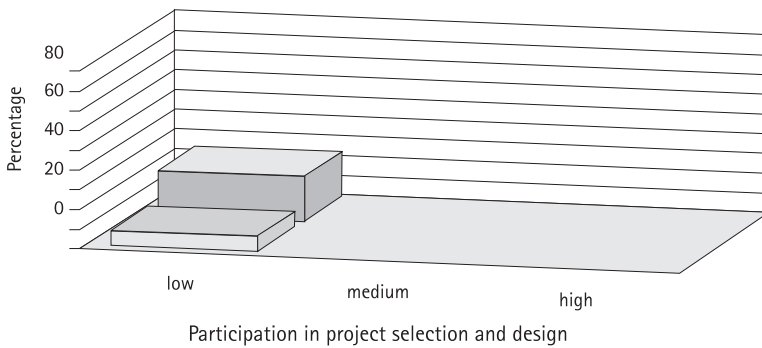
25 *IMF Global Indicators*, 2003, figure 1.1.

The *European Union* is an instructive example of how some political elites see the relationship between democracy and economic prosperity. The original *raison d'être* of the *European Union* was to prevent the kind of conflict between European nations that characterised the continent before the end of the second world war and to prevent the re-emergence of totalitarianism in the countries that became its members. One of the insights was that economic prosperity is a precondition for the success of democracy and that an internal free market, ie, liberal economic policy, would promote economic prosperity and, hence, stability. At the same time, however, the *European Union* was considered to be a union of democratic nations. This interlinkage is present even today in the preconditions for membership. In order to become members candidates have to be sufficiently developed in economic terms, have to have made considerable progress in dismantling command structures in their respective economies and have to accept and implement the opening up of their markets to internal and international competition. At the same time, they have to be sufficiently democratic in that they are not countries that only go through the motions of democracy. They have to be liberal democracies in the sense outlined above and in the previous chapter of this book. The assumption is that common effort in both areas – the economic and political – will bring greater rewards than if countries remain outside²⁶.

Participation and economic performance

When we talk about democracy we are usually referring to the overall political system of a country as such. Democra-

tic processes underneath this level, where political participation can also be very real and direct, are often overlooked. Such processes have an effect on the economy, of course.

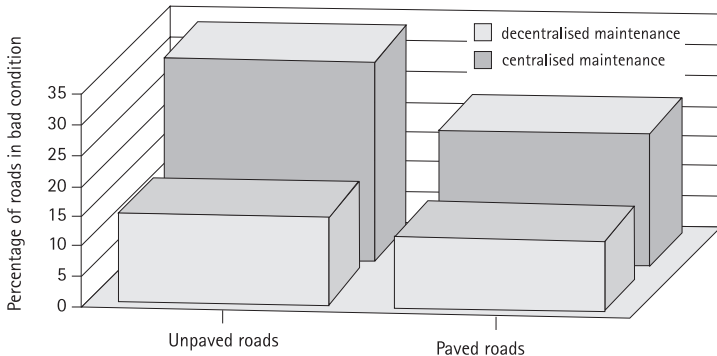


Study of 121 completed rural water supply projects (World Bank, World Development Report 1994, Oxford: Oxford)

In the field of development cooperation participation by beneficiaries is seen to be an essential ingredient for the successful planning and executive of projects. The evidence is impressive. The above figure summarises the results for a total of 121 rural water supply projects in Africa, Asia and Latin America funded by various agencies. Low participation rates result in low effectiveness and low maintenance levels. The higher the participation, the greater the likelihood of successful outcomes is.

Decentralisation also implies greater participation in the sense that central authorities relinquish control over the planning and running of projects. Projects in local hands seem to produce better results as the following example indicates. A survey of 42 developing countries shows that road maintenance tends to be better where responsibility is local.

FIGURE 5: Countries with decentralised road maintenance have better roads



Data from 42 developing countries (World Bank, World Development Report 1994, Oxford: Oxford University Press, 1994, p. 75)

The reason for this may well be that the proximity to those using roads increases accountability.

Taken together, such results undermine the case for authoritarian or centralised economic planning and control. Participation and localised responsibility pays dividends not only, but also, in economic terms.

Direct democracy and economic performance

We also have examples of direct participation by citizens at a political level. In many countries representative democracy, in which decision-making power is delegated to politicians, is complemented by direct democracy. What are the effects of direct democracy on economic performance?

Simplified somewhat, the argument is as follows: representative or indirect democracy tends to promote the following negative tendencies, both of which are bad for the economy:

- Election campaigns are based on promises, many of which cost money, especially those that involve increasing the level of social security or handing out subsidies. Some of these promises have to be kept for reasons of credibility. Often this can only be done if taxes are increased – and tax increases are a burden for both the consumer and for enterprise;
- The number of issues covered by election campaigns is limited, the result being that citizens only have a say in

matters that are covered. Tax increases are a theme to be avoided at all costs, particularly if such increases affect potential supporters. Few citizens would vote for increasing the taxes they have to pay.

Pandering to special interests, and the lobbies that support them, can become a serious problem for indirect democracy. Indeed, many developed countries are finding it extremely difficult to resize welfare systems because of the power that special interests groups have amassed and wield after years of lavish spending.

Direct democracy is probably more awkward and time-consuming than indirect democracy. It makes life more difficult for policy makers and politicians. On the other hand, when citizens are directly involved in decision-making that costs money one would expect them to be cautious in what they decide. One tends to be more careful spending one's own money than in spending other people's money. There is considerable evidence to show that direct democracy pays economic dividends. A survey of relevant studies in Switzerland and the United States brings a number of interesting insights to light, including the following:

- State expenditure and public debt tend to be lower in direct democracies than in representative democracies;
- The willingness to pay taxes is higher in systems with a high level of direct democracy. This increases the efficiency of the tax system;

- Gross domestic product is significantly higher in Swiss cantons that have a high level of direct democracy when compared with other cantons²⁷.

Direct democracy, if the evidence is to be trusted, seems to increase the accountability of politicians and this in turn has beneficial effects for the economy.

Democratisation and entrepreneurship in historical perspective

If we look at the inter-relationship between democracy and wealth in a broader historical perspective we see that the development of democracy as we know it was preceded by a gradual but incessant decline of absolutism. This decline was an important precondition for the emergence of an

27 These observations are taken from Lars P. Feld, *Demokratie und ökonomische Effizienz. Einige Anmerkungen*, keynote statement at a seminar on “Ordnungskompatible Demokratie” organised by the *Arbeitsgemeinschaft selbstständiger Unternehmer* and the *Unternehmerinstitut e.V.*, Bonn, 31 May–1 June 1996 in St. Gallen, Switzerland. The author surveys a large number of relevant studies. The results of 16 such studies are summarised in: *Für Effizienzstaat und Direktdemokratie*, Berlin: Unternehmerinstitut e. V., 2001, p. 86. It’s interesting to note the fact that the aforementioned event on economic policy and democracy focused on direct democracy. Another interesting study by Aymo Brunetti looks at the positive economic effects of direct democracy from a different perspective: the possibility of exercising a veto through direct democracy. This amounts to a check on the activities of the executive and legislature (*How to Create Political Stability. The Growth-Enhancing Effects of a Direct Democratic Veto*, University of Basle, 1994). One could say that the threat of a popular veto concentrates the mind.

entrepreneurial class, a private sector and a free market. The same processes that heralded the emergence of democracy were responsible for economic progress.

Societies with absolutist forms of government in which power is concentrated and secure in the hands of a few are rarely in a position to tackle underdevelopment and economic stagnation because the need to do so is not apparent. Change only comes about, if at all, as a response to a perceived threat of calamitous proportions (eg, the case of Japan) or if it forced upon them from the outside.

The first steps towards political and economic autonomy for significant proportions of society in Europe – first steps towards democracy and independent entrepreneurship – came as a result of competition between feudal lords, between the aristocracy and the monarchy, between ecclesiastical and temporal power and between cities/towns and rural areas. Those cities and towns that were successful – and there were many – used these conflicts in a masterful manner to secure and amass privileges for themselves and the commercial activities on which they depended for their survival. Commerce depends on the development of rights protecting commercial interests, especially rights such as the right to property, the right to enter into contractual relationships and the right to free movement which was originally only foreseen for the feudal classes. The struggle for such privileges was a political struggle although the aims were commercial. The *Hanseatic League* is perhaps the most visible result of such processes taking place in various parts of

Europe. We are reminded of figure 1 in this chapter outlining the factors that promote the development of democracy.

Such a process was only possible in societies whose structures were not unitary and rigid, but in which there were fault lines. Despite the hierarchical ideal, medieval society contained the seeds of its own demise. Comparable conditions did not exist in Russia, in China or in large parts of the Islamic world. This is perhaps part of the reason for the long delay the latter experienced before processes of development and democratisation could commence.²⁸

Even today we have enough evidence to show that autocratic structures and the mentality they breed are a barrier for both the development of democratic institutions and the development of entrepreneurship. Russia is a good example. Today's government is very wary of the power of the economic "oligarchs" and will step in immediately to check

28 A comprehensive description of the process of differentiation and its economic effects is to be found in Nathan Rosenberg & Luther E. Birdzell, *How the West Grew Rich: The Economic Transformation of the Industrial World*, New York: Basic Books, Inc., 1986, especially chapters 2–4 as well as in David S. Landes, *The Wealth and Poverty of Nations: Why Some are so Rich and Some so Poor*, New York: W.W. Norton & Co., 1998. Landes explains that technological progress makes little sense in absolutist systems – irrespective of whether the case in point is imperial China or the hierarchical and rigid caste system of India – because the wealth of the ruling elite was secure. There was no need rationalise or to reduce costs. There was no point in technological progress which could reduce the need for labour. Indeed, the effects could definitely be dangerous for the stability of such systems.

any political ambitions such entrepreneurs might show. The country is also a good example of how difficult it is to promote entrepreneurship on a broader scale, eg, in the fields of small enterprise.

Interestingly, the same can be said for southern Italy. The introduction of regional self-government in 1970 has led to very different results. According to the results of a well-known study by Robert Putnam, regions with long urban traditions of self-government and civic participation – as in the former city republics of the north – were much more successful in implementing these reforms and benefiting from them than regions of the south whose precursors were the kingdoms of Naples and Sicily. They were not as successful despite massive injections of funds for their development. Long established traditions of civil society seem to be an important precondition for successful entrepreneurship and development on a broad scale and for a viable and efficient system of democratic self-government²⁹. Putnam comments that

“In the north, norm of reciprocity and networks of civic engagement have been embodied in tower societies, guilds, mutual aid societies, cooperatives, unions, and even soccer clubs and literary societies. These horizontal civic bonds have undergirded levels of economic and institutional performance generally much higher than in the South, where social and political relations have been vertically structured. Although we are accustomed to thinking of the state and the market as

29 Robert Putnam et al., *Civic Traditions in Modern Italy*, Princeton: Princeton University Press, 1992.

alternative mechanisms for solving social problems, this history suggests that both states and markets operate more efficiently in civic settings.”³⁰

The control mechanisms and institutions of liberal democracy and economic growth

If we use a narrow definition of democracy – countries in which regular elections are held as the only criterion – the links between democracy and economic growth are much weaker. This we see when we look at the performance of many states that emerged with the collapse of the Soviet Union, limited democracies. However, if we use a broader definition of democracy closer to the liberal ideal a different picture emerges.

A relatively recent study of OECD and developing countries under the auspices of the OECD demonstrated that there was no significant relationship between economic growth and the existence of democracy in the formal sense of the term (existence of elections). An unreliable, unpredictable institutional framework, however, was found to be costly for economic growth. Other factors were “some forms of political violence and related low levels of personal and property security; and non-transparent law enforcement and disorderly government change.”³¹ The author, Aymo Brunetti,

30 *Ibid.*, p. 181.

31 Aymo Brunetti, *Politics and Economic Growth – A Cross-Country Data Perspective*, Paris: OECD Development Centre, 1997, p. 145.

concluded that "... stability and predictability of an institutional framework seem to be the most important features of a political system for encouraging economic growth"³² and went on to observe that "Democratic control mechanisms, including a working separation of powers or a well-established party system, are likely to reduce policy unpredictability."³³ These, of course, are more likely to exist in well-developed democracies and less likely in authoritarian or illiberal democracies. "The research clearly suggests that limiting discretionary governmental powers consolidates private sector confidence in the political framework which can in turn stimulate growth."³⁴ A growth-enhancing political system requires "a transparent, orderly, incremental law-making process that allows affected parties to be forewarned and empowered to raise concerns."³⁵

In this connection we should remember that the first industrial revolutions occurred in countries that have the oldest democratic traditions. When we refer to these traditions, we are not referring primarily to formal democratic rights of participation. Indeed, there was no universal suffrage at the time. But the abovementioned factors were in place, factors that are important for a liberal concept of democracy. These

32 Ibid., p. 12.

33 Ibid., p. 13.

34 Ibid., p. 13.

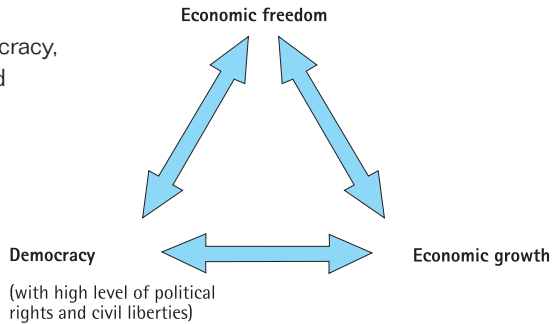
35 Ibid., p. 145.

countries have, in the meantime, become fully-fledged democracies in the formal sense of the term as well. Needless to say, they continue to enjoy a very high level of economic stability and competitiveness.

The links between democracy and a market economy

We have looked at the links between democracy and economic growth or economic development. We have already established that economies that perform well tend to enjoy a high level of economic freedom. We would thus imagine that there is a strong link between democracy and economic freedom.

FIGURE 6:
Links between democracy,
economic growth and
freedom



A look at the following table shows that this seems to be the case. Economic freedom is much rarer in countries without democracy or with underdeveloped democracy. Developed democracies with high ratings for political rights and civil liberties almost always have a fully developed market economy. Of the four market economies with very low ratings for

political rights and civil liberties, it is interesting to note that according to the *International Country Risk Guide*, the United Arab Emirates, Oman and Bahrain achieve relatively high scores for “rule of law.”³⁶

TABLE 3: Democracy and a market economy

	Countries with a high level of economic freedom (= market economy)	Countries with little or no economic freedom
Democracies with high ratings for political rights and civil liberties 52 countries	Australia, Austria, Bahamas, Belgium, Botswana, Canada, Chile, Costa Rica, Czech Rep., Denmark, Dominican Rep., El Salvador, Estonia, Finland, France, Germany, Greece, Iceland, Hungary, Ireland, Italy, Jamaica, Japan, Latvia, Luxembourg, Mauritius, Namibia, Netherlands, New Zealand, Norway, Panama, Peru, Philippines, Portugal, South Africa, South Korea, Spain, Sweden, Switzerland, Taiwan, Thailand, United Kingdom, United States, Uruguay 44 countries	Barbados, Benin, Bulgaria, Ghana, Mali, Papua New Guinea, Romania, Slovakia 8 countries

36 See table 2.1 (Countries with large gaps between rule of law and electoral rights indexes, scores for 1998) in 2000 *Index of Economic Freedom*, Washington D.C.: Heritage Foundation & New York: Wall Street Journal, 2000. p. 37.

Table 3 (continued):

	Countries with a high level of economic freedom (= market economy)	Countries with little or no economic freedom
Autocracies or pseudo-democracies with very low ratings for political rights and civil liberties 17 countries	United Arab Emirates, Oman, Bahrain, Kenya 4 countries	Cameroon, Iran, Chad, China, Pakistan, Rwanda, Syria, Burundi, Congo, Republic of, Guinea-Bissau, Algeria, Zimbabwe, Myanmar 13 countries*

Sources: *Economic Freedom of the World*, Annual Report 2003, opus cit., p. 86–88 (data for 2001). Countries with a summary rating above 6.5 are considered to be market economies, countries with a summary rating below 6.0 are considered to have relatively little or no economic freedom. Many undemocratic countries are not included in the survey.

Democracy ratings are from the Freedom House website, www.freedom-house.org/research/freeworld/2002/combinedaverage.pdf and www.freedomhouse.org/research/freeworld/2002/combinedaverageterritories.pdf (data for 2001; democracies with high ratings for political rights and civil liberties = countries with ratings of 2 and above; autocracies or pseudo-democracies with low ratings for political rights and civil liberties = countries with ratings of 6 and below).

When looking at the box with the 13 countries that are both undemocratic and have no market economy we should bear in mind the fact that dictatorships such as Afghanistan, Sudan, Burma, Libya, Turkmenistan, North Korea, Iraq, Somalia, Bhutan, Belarus, and many others, are not included.

ed in the economic freedom surveys published by the *Fraser Institute*. These countries do not have market economies.

The struggle for democracy and economic performance: some conclusions

Democracy is popularly seen as a means for attaining prosperity. The struggle for democracy is often also a struggle for prosperity (when it doesn't exist) or for maintaining prosperity (where a measure of prosperity has been achieved). In the latter case, democracy is seen as a means of protecting one's economic interests against potentially harmful or arbitrary policies.

Demands for democratisation are more likely when citizens have attained a certain level of income.

Democracies are no barrier to good economic performance. Indeed, if it were so, the richest countries of this world would not be democracies. Democratic participation seems to increase the potential for good economic policy rather than to decrease it. Indeed, there is some evidence that the more direct the participation, the better this will be for the economy. In the field of development more participation seems to enhance the chances of success.

If politicians are to defend democracy, they must pursue policies that sustain prosperity (developed countries) or produce high levels of growth (developing countries).

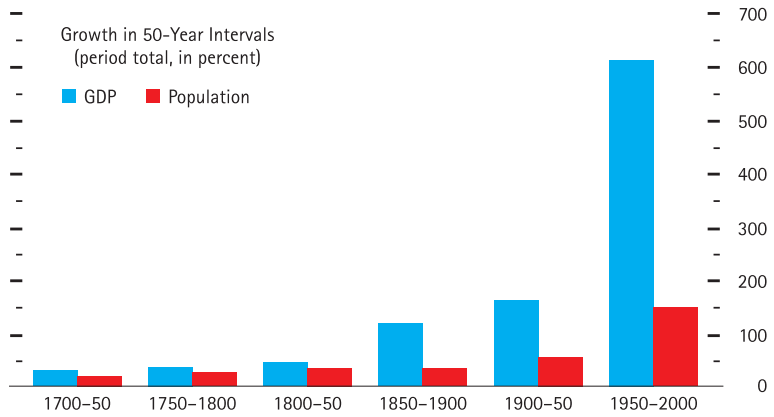
Poverty and the distribution of wealth – can we be optimistic about the future?

We have seen enormous progress in the generation of wealth. Growth in world GDP has accelerated over the last two centuries and outstrips the growth in world population. Have we all benefited? The important political question is: how do we ensure that all benefit?

The overall level of wealth might mask considerable disparities in the distribution of income. Some parts of the world might not be participating in this process at all. The pace of advance might be different between countries. A wealthy country might have many poor people. There might even be extreme poverty in such countries, but how likely is this? Low disparities between rich and poor in wealthy countries would mean a good standard of living for all. In poor developing countries, big disparities mean extreme poverty for the lower income groups; low disparities mean relatively few people who are very wealthy.

How useful is it to look at income disparities, rather than poverty? Do disparities give an accurate picture of the real living conditions of the poor? How should policy makers tackle the problem of disparities, if at all – or should the focus be on poverty?

FIGURE 1: World GDP growth and population growth since 1750¹



These are important questions in view of the criticism emanating from the increasingly vocal and growing cohorts of the anti-globalisation movement. Their claim is that development focusing on policies to foster and increase economic growth is misconceived, that disparities between rich and poor are growing, and that poverty and marginalisation are increasing.

I believe that disparities matter *if they are large* for reasons of security and for social and economic reasons: Where wealth is concentrated in the hands of a few, the likelihood is that

¹ Source: *World Economic Outlook*, Washington: International Monetary Fund, May 2000, p. 150, based on Bradford J. DeLong, *Estimating World GDP, One Million B.C.-Present*. University of California at Berkeley, 1998, available via the internet at: <http://www.j-bradford-delong.net>.

- opportunities and services available to a large part of the population are limited,
- social tensions and crime levels are high,
- defences of a very large part of the population against the effects of economic downturn and inflation are low
- the ability of poorer sections of the community to invest is limited.

Furthermore,

- interest in participating in political and civic life might be much reduced: “The system is not fair on us. So why should we care for and support it?” Stakeholders are more likely to participate.

Human beings, as soon as they are aware of their rights, develop expectations and a strong sense of what is fair. Those liberals who criticise the use of “envy” in politics and political campaigning are mistaken. To measure one’s performance and income against others and the attempt to catch up is an inherent part of the achievement motive, a motor of development. **Catching up implies reducing disparities.**

In chapter 2 we had a first look at disparities. We established that wealthy countries have lower disparities between rich and poor than many poor countries and we saw that high per capita gross national income is never accompanied by extreme disparities. This says little about a) the disparities

between rich and poor countries, which might be increasing and b) about disparities in poorer countries. But again, how much does disparity tell us about the actual condition in which poorer members of society find themselves in?

Some observations on the distribution of income

The first thing it might be useful to look at is whether or not growth increases disparity, ie, produces a situation in which the rich get richer and the poor poorer. Contradictory evidence exists on whether inequality is increasing or not – but much depends on what is measured and how it is measured. A comparison of countries and their relative wealth to one another might yield different results to a comparison between the wealthy and poor inhabitants of this world. When comparing the lowest tenth of the population with the highest tenth, the picture of inequality might seem different to when measuring the lowest fifth with the highest fifth. Indeed, the most vivid representations of growing disparities are based on richest 10 %/poorest 10 % comparisons.

The *United Nations Development Programme* (UNDP) now admits that its statistics until 1999 overstate the case for increasing disparities between the world's richest and poorest people. This is an important admission because many of the criticisms of globalisation are based on statistical evidence produced and popularised by the UNDP. According to the organisation, the ratio of income of the richest 20 % to that of the poorest 20 % increased from 34 to 1 in 1970 to 70 to

1 in 1997. Currency exchange rates were used for the calculations. But when differences in purchasing power are taken into account, and purchasing power parity conversion rates are used, the ratios for the same period were 15 to 1 and 13 to 1 respectively – indicating that the disparities in real terms are lower than previously thought and disparities are not increasing.²

The most remarkable evidence for a reduction of disparity at a global level comes from a Norwegian study using World Bank data. The results show that, “with some fluctuations over time, world inequality declined continuously during the three decades from 1968 to 1997.”³

Interesting support for the view that disparities are declining come from another source as well, a recent IMF survey (figure 3). The focus is, again, not on what is happening at the extremes, but on the overall picture. The figure shows how rising incomes, especially in Asia, are creating what, in world terms, could be described as a huge middle class. As the

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- 2 UNDP, *Human Development Report 2001: Human development – past, present and future*, Oxford: Oxford University Press, 2001, p. 20. If the focus is on the poorest and richest 10 %, however, even PPP estimates show a worsening situation for the same period. The result depends on what is measured. Gini coefficients (see below) give a more positive picture because they capture what is happening in the “middle ground” as well.
 - 3 Arne Melchior, Kjetil Telle, Henrik Wiig, *Globalisation and Inequality: World Income Distribution and Living Standards, 1960–1998*, Royal Norwegian Ministry of Foreign Affairs, Studies on Foreign Policy Issues, Report 6B: October 2000, p. 15.

bulge moves to the right of the chart, so incomes are becoming more equal.

FIGURE 2: Gini coefficients for world income distribution using PPP-adjusted income data (1965–97)⁴

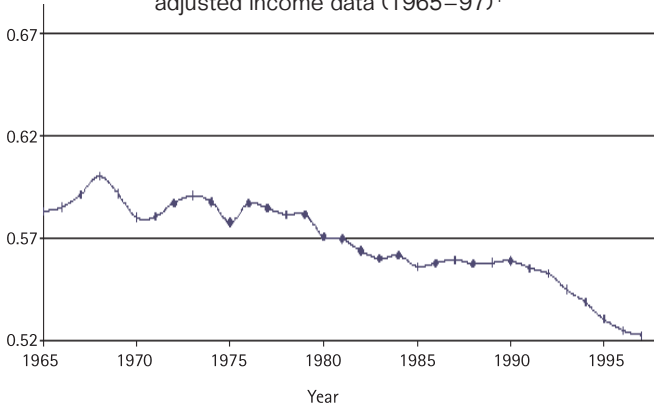
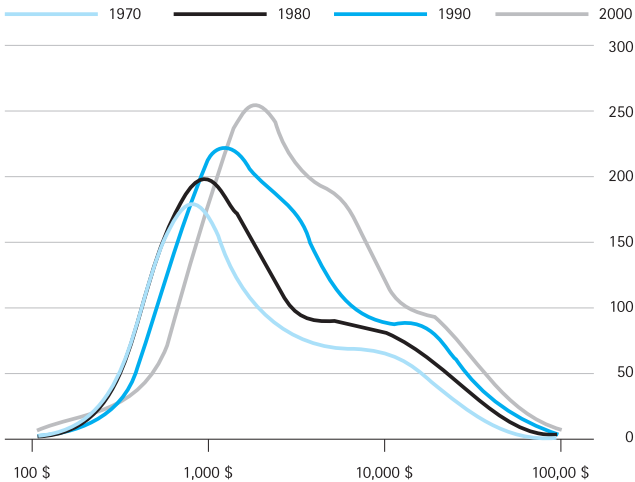


FIGURE 3: Bulging towards equality: world distribution of annual income (people in millions)⁵



The above figures use data on average income in each country. Ideally, we would use income data for every person of this world to eliminate bias due to disparities within countries. Unfortunately, such data does not exist.⁶

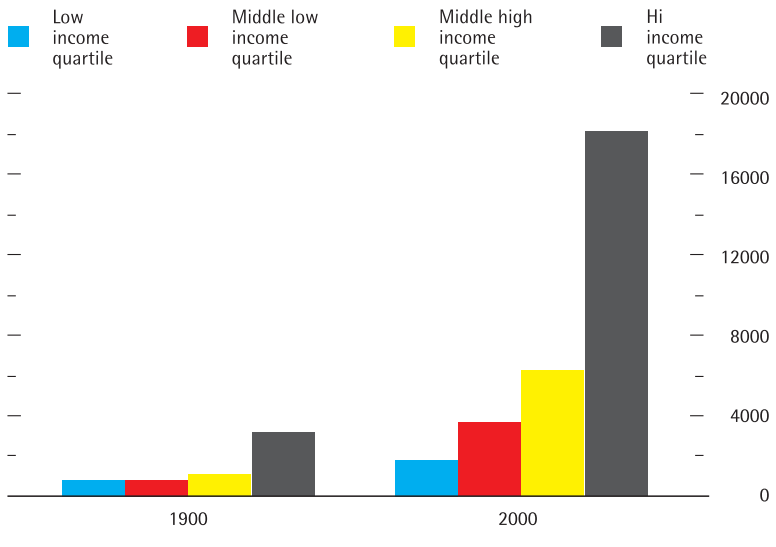
Even if we are sceptical of such evidence and accept, instead, that there are increasing disparities, this does not necessarily mean that the poor are getting poorer in absolute terms. The following figure shows that between 1900 and 2000 per capita income has risen faster in the rich than in the poor countries. At the same time, however, it also shows that it has increased substantially for poorer parts of the world's population as well.

Let us look at figures for the last 40 years for the various regions of the world (figure 5). It shows that inequality in Latin America is very high in international comparison but

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- 4 The Gini coefficient is a measurement of income disparity. The closer to 0, the more equal the distribution of wealth. 0 represents perfect equality, while 100 implies perfect inequality.
 - 5 Source: *Survey Capitalism and Democracy – radical birthday thoughts*, London: *The Economist*, 26 June 2003 (taken from Xavier Sala-i-Martin, *What is behind the declines in global income inequality and poverty*, IMF Survey, 17 March).
 - 6 Arne Melchior, op. cit., p. 18, asks the question: "Assume, hypothetically, that we had a "true Gini" based on every person's income, and then recalculated the index based on country averages. How much information would be lost?" According to the author the "literature in the field suggests that the main contribution to inequality in the world is observed between, not within, countries... Quantitative estimates indicate that 80–90 % of world inequality is captured by the between-country component."

falling over time. Inequality in Sub-Saharan Africa has increased considerably in the 1990s. Inequality in Eastern Europe has increased, but from a low level. The region is still the most “egalitarian.” In Asia and in rich countries, inequality is at an intermediate level and the average has not changed appreciably over time.

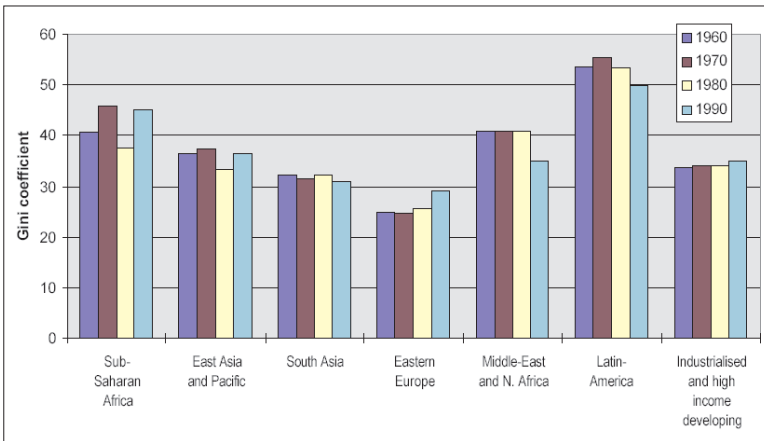
FIGURE 4: Rise of income inequality (per capita GDP in 1990 purchasing power parities)⁷



7 Source: *World Economic Outlook*, May 2000, op. cit., p. 154 (based on: Angus Maddison, *Monitoring the World Economy 1820–1992*, Paris: OECD, 1995, and IMF staff estimates). Countries’ populations have been assigned to income quartiles according to GDP per capita in each country; each quartile contains 25 percent of world population.

It is interesting to see that East Asia and the Pacific, an area with very high growth rates, is an area in which the Gini coefficient is similar to the average for industrialised countries. Disparities in Africa are considerably higher. So is there a link between the distribution of wealth and economic performance?

FIGURE 5: Regional Gini coefficients. Population-weighted averages based on available country observations within each decade⁸



Many states that have recently achieved very high levels of economic growth, over 5 % per annum, are countries with relatively small differences between rich and poor – seen, of course, from a comparative perspective. The Gini coefficients for many Latin American and African countries are

8 Arne Melchior, op. cit., p. 19.

much higher. Those for the UK and USA are 40.8 and 36.8 respectively. Because the Gini coefficient for wealthy countries is usually below 40, indeed often below 30, it would be hard to imagine it increasing for developing or rapidly industrialising countries beyond the level it is now at. Historical evidence would also seem to point in this direction.

TABLE 1: Economic performance and Gini coefficient

		Annual GDP growth rate 1990–2001	Gini coefficient
Largest developing countries	China	10.0 %	40.3
	India	5.9 %	37.8
Small industrialised countries	Ireland	7.6 %	35.5
	Israel	5.1 %	38.1
Mid-sized south-east Asian countries	South Korea	5.7 %	31.6
	Vietnam	7.6 %	36.1
Small developing countries	Sri Lanka	5.1 %	34.6
	Uganda	6.8 %	37.4

Of course, as I have already said, figures relating to growth and distribution of income might mask serious problems of poverty on the ground. We would suspect this to be the case with India, for instance. Statistical evidence, interestingly enough, points in a different direction:

TABLE 2: Economic growth and income poverty: strong links⁹

Region	Growth in the 1990s (annual per capita income growth)	Poverty reduction in the 1990s (percentage point reduction using the \$1 a day poverty line)
East Asia and the Pacific	6.4%	14.9
South Asia	3.3%	8.4
Latin America and the Caribbean	1.6	-0.1
Middle East and North Africa	1.0	-0.1
Sub-Saharan Africa	-0.4	-1.6
Central and Eastern Europe and the CIS	-1.9	-13.5 ^a

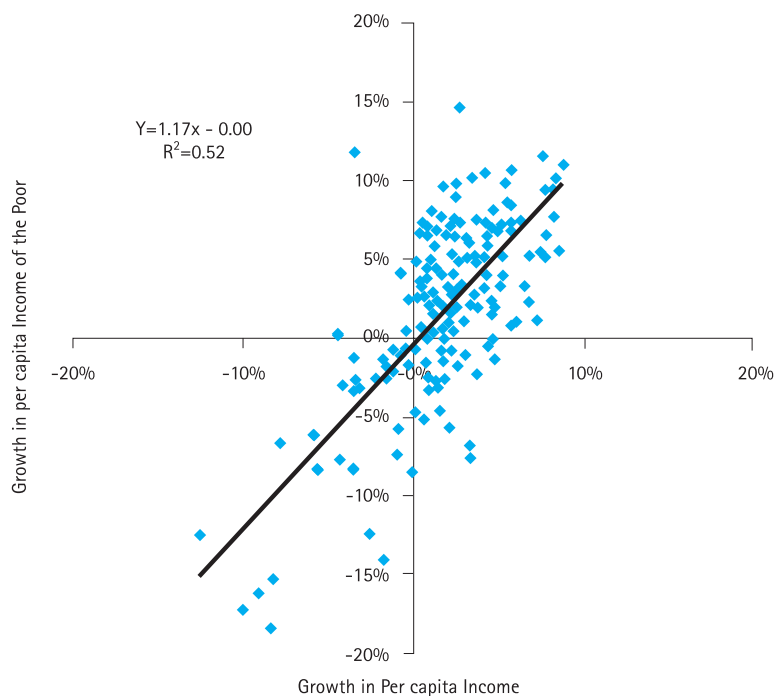
a. Change measured using the \$ 2 a day poverty line, which is considered a more appropriate extreme poverty line for central and eastern Europe and CIS

Interestingly, high growth rates seem to be accompanied by considerable reductions of extreme poverty whilst low growth produces little change. Negative growth as in Central and Eastern Europe and the CIS taken as a whole leads to considerable increases in poverty. Such observations are

9 UNDP, *Human Development Report 2003, Millennium development goals: a compact among nations to end human poverty*, Oxford: Oxford University Press, 2003, p. 42.

backed by global statistics that show a very close correlation between growth of per capita income and participation in this growth by the poorest 20 of the population.¹⁰

FIGURE 6: Growth of per capita income and growth of income of the poorest quintile in 80 countries for observations covering four decades (1960–2000; 236 observations each covering a period of at least five years)



10 David Dollar & Aart Kraay, *Growth Is Good for the Poor*, The World Bank, March 2000, Development Research Group discussion paper, p. 41 (www.worldbank.org/research/growth/pdfiles/growthgoodforpoor.pdf).

The authors point out, for instance, that there are 108 episodes in which per capita GDP grew at a rate of at least 2 % per year and that in 102 of these episodes, income of the poor also rose.

Are we seeing an elimination of poverty and increase in well-being?

If we look at long term global statistics on development, there are few reasons for suspecting that the world as a whole is on the wrong path. These statistics seem to support an optimistic interpretation of how disparities are developing: the poorer parts of the world's population are not getting poorer. Many countries have been able to participate in technological and economic progress and it is useful to look at the evidence. The UNDP itself – which tends to paint a gloomier picture than organisations outside the ambit of the United Nations – points to considerable progress.

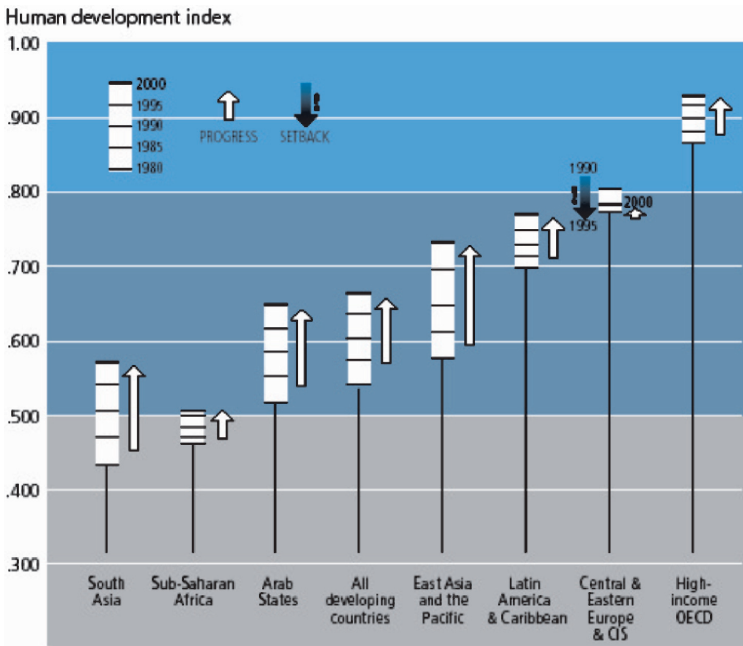
This is seen most clearly when we look at the UNDP's human development index over time. The index is a composite one measuring “average achievement in three basic dimensions of human development – a long and healthy life, knowledge and a decent standard of living” using data primarily from other international organisations, the United Nations Population Division, UNESCO and the World Bank. It is measured by life expectancy, educational attainment (adult literacy and combined primary, secondary and tertiary enrolment) and adjusted income per capita in purchasing

power parity (PPP) US dollars.¹¹ Improvement has been constant between 1960 and 1998:

Least developed countries:	from 0.161 to 0.435
All developing countries:	from 0.260 to 0.642
Industrialised/high income countries:	from 0.798 to 0.920

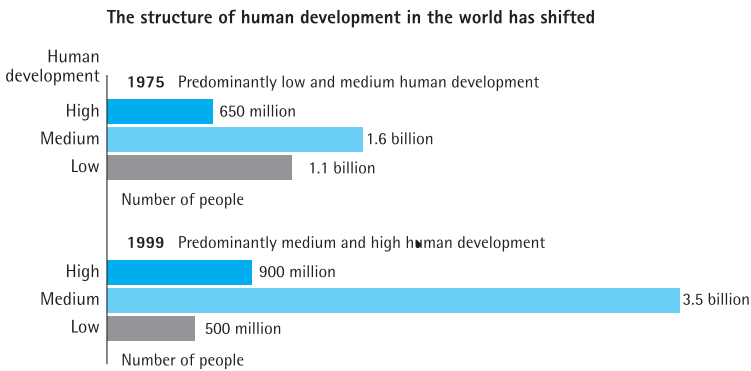
More detailed current figures show that all regions saw an substantial increase in the levels of human development – with one exception: central and eastern Europe and countries of the former Soviet Union between 1990 and 1995, the period immediately after the velvet revolution.

FIGURE 7: Progress in human development by region 1980–2000¹²



Put into simple language, the quality of life has increased whether we are looking at least developed countries or at developing countries in general. People are generally living longer lives than they were before and they are enjoying more educational opportunities. Nevertheless, the developing world as a whole hasn't reached the level of human development enjoyed by industrialised countries in 1960.

FIGURE 8: Progress in human development 1975–1999¹³



If we look at figure 8 we see that the number of people at a low level of human development has been more than halved. At the same time the number of people enjoying high levels

11 UNDP, *Human Development Report 2003*, op. cit., p. 190 & 353 and *Human Development Report 2002*: op. cit., p. 14.

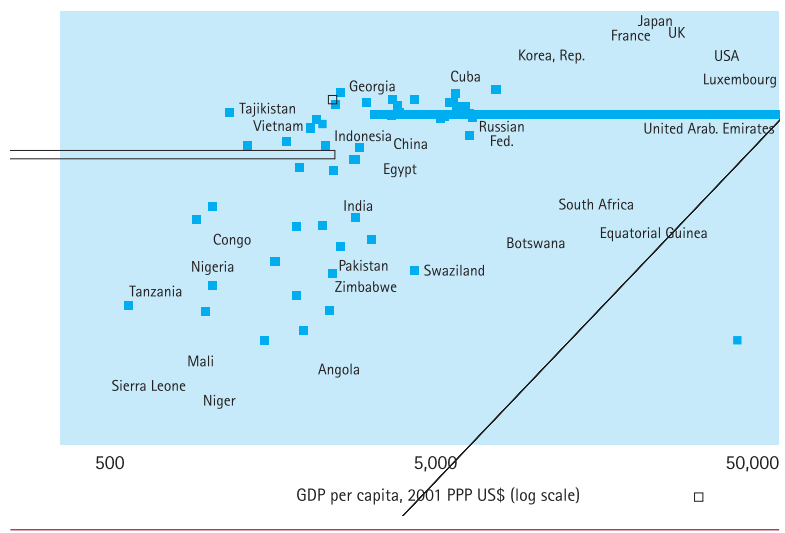
12 *Human Development Report 2003*, op. cit., p. 61.

13 *Human Development Report 2001*, op. cit., p. 11. Data refer only to countries for which data are available for both 1975 and 1999.

of human development is much higher than the number with low levels. This gives further credence to the optimistic view that inequalities in living standards are declining rather than increasing. Another interesting piece of information from the same source indirectly explains what is happening. Over the last 25 years, countries representing 31 % of the world's population, the countries of East Asia and the Pacific, have experienced an average annual growth rate of 6 %. The region contains China and a number of other medium to large developing countries. South Asia, representing 23 % of the world's population has had an average growth rate slightly higher than that of the OECD. It would indeed be surprising if global disparities hadn't declined.

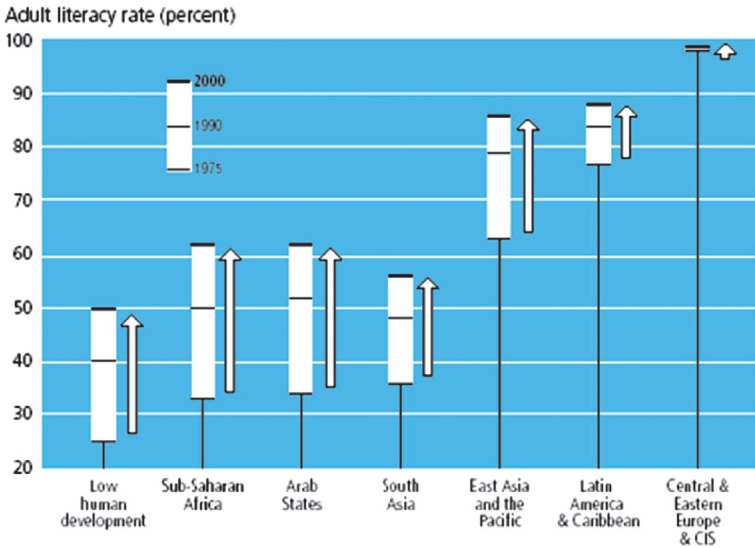


The following graphic shows how closely wealth (measured in terms of GDP at purchasing power parity) and the human development index are linked. The human development index in figure 10 uses the education and longevity components of the original index and omits GDP per capita. It is thus fair to expect that rapid growth will have a considerable effect on increasing human development.



Finally, let us look at developments in the field of education and, specifically, literacy. Illiteracy is one the handicaps of the very poor. Here again, we see constant progress over the last 25 years in all parts of the world, the biggest increases in the poorest parts of the world.

FIGURE 10a: Progress in achieving literacy 1975–2000¹⁶



Of course, there is extreme poverty around and I would be the last to suggest that this is not a problem. But it is a problem that can be tackled and is being tackled with considerable success. The success is linked to progress in econom-

¹⁶ *Human Development Report 2002*, op. cit., p. 22 (based on UNESCO statistics for 2002).

ic development. The prosperity brought about by economic development is a precondition for success in tackling poverty and creating a better standard of living. If it were not so, we would not have such a close relationship between wealth and human development. What is more, all important measures show that the very poor and poor benefit from development. There is no indication showing that the poor get poorer as a result of economic development. Indeed, it seems as if the poor suffer disproportionately when growth is negative.

The share of people living in extreme poverty, surviving on less than \$1 a day, fell in the 1990s from 30 % to 23 % – or by 123 million. A longer term perspective is even more impressive. If we take an income benchmark of \$2 a day or less, adjusted to cater for differences in purchasing power, the proportion of the world's population in poverty dropped from 56 % in 1980 to 23 % in 2000. Before 1980, the absolute numbers were rising. Since, there has been a massive decline.¹⁷

The achievements have been impressive, but much remains to be done. But there are still about 1.2 billion people living in extreme poverty today, concentrated mostly in Sub-Saharan Africa and South Asia (about 70 percent of the total for both areas taken together).

17 *Survey Capitalism and Democracy*, op. cit. (citing a study by Surjit S. Bhalla, *Imagine There's No Country: Poverty, Inequality and Growth in the Era of Globalisation*, Institute for International Economics, September 2002).

Economic freedom, liberal democracy and the improvement of conditions of life

The reason for poverty is, I believe, bad governance. Economic freedom and liberal democracy amount to good governance, policies that enhance growth and freedom, both of which are objectives of development, at least from a liberal point of view.

It is not an accident that many countries that are ranked as “low human development” have negative growth rates and tend to have low economic freedom ratings and low freedom ratings (see table 3). There are only two countries that can be rated as being economically free, Zambia and Uganda. There are only three countries rated as being free (free in terms of civil liberties and political rights). Kenya with a negative growth rate for 2001 has since seen a change of government – something that other countries with negative growth rates cannot achieve without introducing democracy. Other democracies with negative growth rates obviously need to do something with regard to their economic policy.

The table, however, paints a static picture. We would suspect, in accordance with observations made in the previous chapter, that economic success will eventually lead to demands for democracy and greater rights. We would suspect that low ratings in economic freedom will eventually have a negative effect on growth and perhaps even on democracy, where it exists.

TABLE 3: Low human development and indicators of economic and political freedom

Country and HDI rank (175 Countries)	Position on the Economic Freedom index (123 countries)	GDP per capita growth 2000–2001	Electoral democracy	Freedom (high level of protection of civil liberties and political rights)
142 Cameroon	91 =	3.1	no	Not free
143 Nepal	89	3.4	no	Partly free
144 Pakistan	101	0.9	no	Not free
145 Zimbabwe	121	-9.8	no	Not free
146 Kenya	51	-1.0	yes	Partly free
147 Uganda	44	2.0	no	Partly free
148 Yemen	n.a.	-1.0	no	Not free
149 Madagascar	91 =	3.7	yes	Partly free
150 Haiti	77	-3.5	no	Not free
151 Gambia	n.a.	2.7	no	Partly free
152 Nigeria	91	1.6	yes	Partly free
153 Djibouti	n.a.	-0.3	no	Partly free
154 Mauritania	n.a.	1.4	no	Partly free
155 Eritrea	n.a.	2.5	no	Not free
156 Senegal	82	3.2	yes	Free
157 Guinea	n.a.	0.7	no	Not free
158 Rwanda	106 =	4.3	no	Not free
159 Benin	91 =	3.1	yes	Free
160 Tanzania	69	2.3	no	Partly free
161 Côte d'Ivoire	81	-3.3	no	Partly free
162 Malawi	115	0.7	yes	Partly free
163 Zambia	42	3.2	no	Partly free

Table 3 (continued):

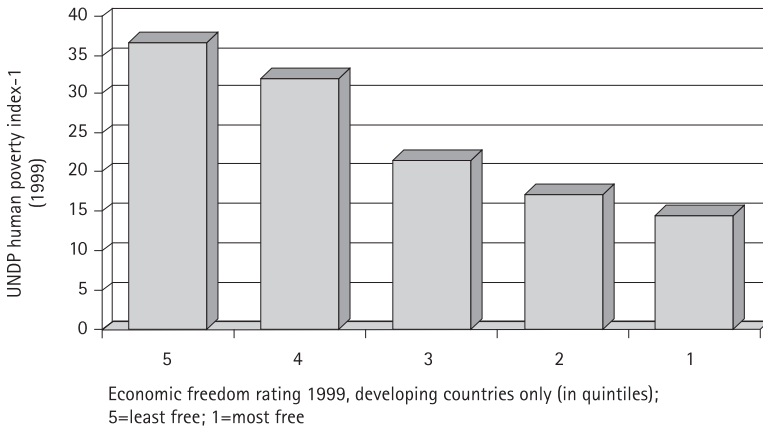
Country and HDI rank (175 Countries)	Position on the Economic Freedom index (123 countries)	GDP per capita growth 2000–2001	Electoral democracy	Freedom (high level of protection of civil liberties and political rights)
164 Angola	n.a.	0.3	no	Not free
165 Chad	91 =	5.8	no	Not free
166 Guinea- Bissau	119	-2.0	yes	Partly free
167 Congo, Dem. Rep.	n.a.	n.a.	no	Not free
168 Central African Republic	114	0.0	no	Partly free
169 Ethiopia	n.a.	5.4	no	Partly free
170 Mozambique	n.a.	6.7	yes	Partly free
171 Burundi	110	1.3	no	Not free
172 Mali	82	-0.9	yes	Free
173 Burkina Faso	n.a.	3.2	no	Partly free
174 Niger	91 =	1.7	yes	Partly free
175 Sierra Leone	106 =	3.1	yes	Partly free

Sources: UNDP, World Bank, Fraser Institute and Freedom House, most recent annual surveys, figures for 2001.

This is a point we also made in the previous chapter. The continued existence of freedom and democracy most probably depend upon existence of policies that promote economic growth.

What do aggregate statistics tell us about economic policy and their success in increasing human development and decreasing poverty? The following figure shows an impressive relationship between poverty and lack of economic freedom when looking at average scores for human poverty as measured by the UNDP for each quintile free to least free.

FIGURE 10b: Economic freedom and human poverty¹⁸



The same holds true for the relationship between average scores for human development and level of economic freedom, suggesting that policies enhancing economic freedom are the best way forward in terms of improving not only per capita income but also health and education.

18 *Economic Freedom of the World, 2001 Annual Report*, Vancouver: Fraser Institute, 2001, p. 12

FIGURE 11: Economic freedom and human development¹⁹

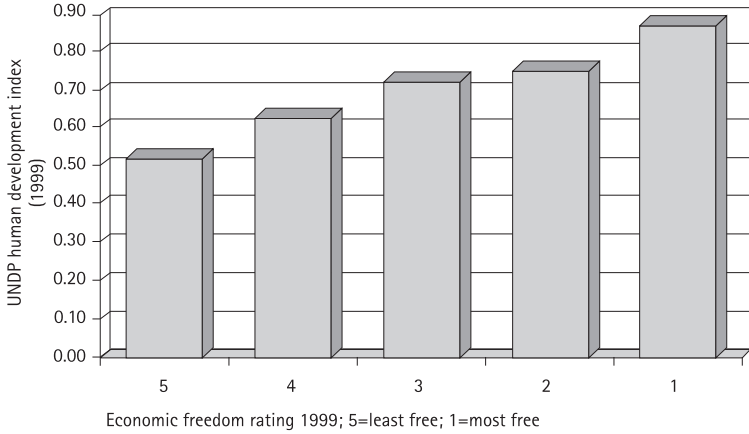
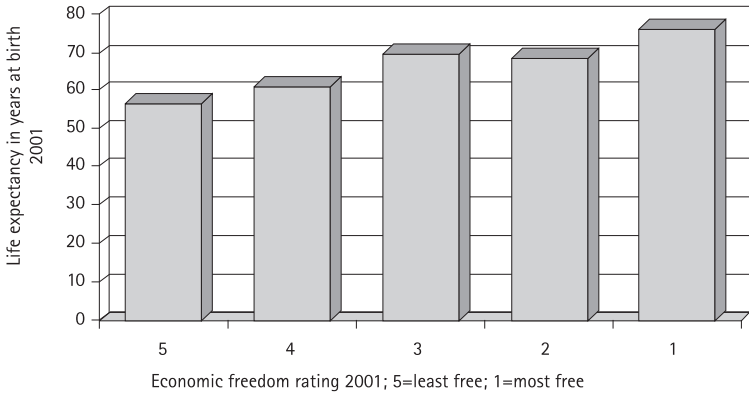


FIGURE 12: Economic freedom and life expectancy²⁰



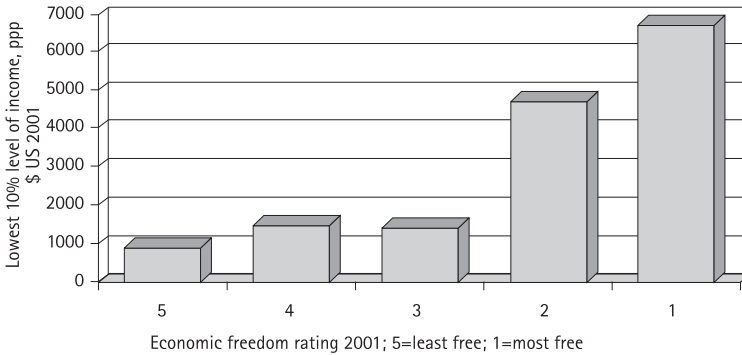
19 Ibid p. 11.

20 *Economic Freedom of the World, 2003 Annual Report*, Vancouver: Fraser Institute, 2003, p. 21.

That this is not only a statistical vagary can be seen in the following evidence focusing on one element of the human development index only (figure 12) showing that there is a link between life expectancy and freedom.

Given the discussion above, it is also interesting to see whether there is a link between economic freedom and distribution of income. The evidence shows that the level of economic freedom does not have any significant bearing on the share of total income in the hands of the poorest 10 % of the population (2.27 % for the bottom quintile and 2.68 % for the quintile “economically most free”).²¹ But the absolute figures are impressive as figure 13 indicates:

FIGURE 13: Economic freedom and the income level of the poorest 10 %²²



21 *Ibid.*, p. 21.

22 *Ibid.*, p. 21.

The evidence supports the earlier observation that lower and lowest income groups benefit from economic growth. We know from chapter 2 that economic liberty and economic growth are closely linked.

Some conclusions

A look at global, regional and national income disparities has shown that:

- Conclusions depend on what it is that is being measured and how it is measured.
- There is evidence to show that, if differences in purchasing power between countries of this world are taken into account, the overall situation is slowly improving, ie, global differences are declining.
- There are, nevertheless, considerable differences in disparities between countries and between regions. Disparities don't have a clear effect on economic progress in one direction or the other. The most successful economies of this world, however, have lower disparities than the averages for Latin America and Africa.
- It is important to look at absolute figures rather than disparities when looking at the poorer parts of the world's population because such figures might hide real progress on the ground.

- When looking at income disparities within countries it seems that people in the lowest income groups also gain from growth. The poor, in general, do not get poorer.
- If we look at the human development index which measures overall performance for countries not only in achieving higher average income but also in measuring important aspects of quality of life such as health (life expectation) and education (literacy), we find evidence to suggest gradual but steady improvement in the condition of the world's population. This would also suggest that the lot of the world's population as a whole is improving.
- Nonetheless, relevant statistics show that a lot remains to be done. Although we have no more mass famines, we have mass poverty and malnourishment.

There are many other things we have to take into account when trying to find out what is happening at a global level which I haven't covered in this brief survey. One of these is declining real prices for many commodities of daily life throughout the world that are not captured by statistics, but which have undoubtedly contributed to improving the quality of life for large parts of the world's population. An example of such a commodity is electricity.

What are the policies we need to achieve progress, that is, improvement in the condition of the world's poor? They are not primarily policies of world redistribution. Development assistance has not been the way forward. Massive flows of assistance to some of the biggest recipient countries of the

world have not produced the desired results. Sudan, a major recipient of western aid over the past development decades, has hardly progressed at all. Singapore with its domestic policies encouraging markets and growth has – enormously so. Evidence at an aggregate level suggests that liberal policies, policies that enhance economic liberty and good governance, produce superior results. There is a clear link between economic freedom on the one hand and human development and the elimination of poverty on the other.

Whether or not poverty will be eliminated in our lifetime depends on a number of factors. First of all, it depends upon a realistic assessment of what poverty is. It is more difficult to fight poverty effectively if the measures we use are seasoned by the rich country perspective and use concepts more appropriate for a rich social welfare state. Fortunately, this is not the approach being used by the international community.

The most effective approach would be to focus resources on alleviating extreme poverty – because it is people in such condition that are most at risk and most urgently need assistance. A focused approach, avoiding massive transfers engineered by government, would lessen the risk of undermining the economy in the process.

More importantly, however, politicians need to embrace growth-enhancing policies, ie, liberal policies, or face the consequences. It is such policies that offer most hope for the poor and disadvantaged of this world.

Summary and outlook – the way forward

The liberal approach promotes justice

It is true that the world is full of injustice. It is also true that this has always been the case. To blame such injustice on liberal policy – or to use the contemporary catch-all damnation, “neo-liberalism” – is unhistorical and contradicts the facts. The economic problems of the so-called developing world cannot be blamed on freedom or on free markets which are an inseparable part of that freedom. If anything, in most parts of the developing world there has been too little freedom. Where freedom has been used as a method, ie, where liberal policies are in place, the outcomes have been good and certainly much better than those of most authoritarian attempts to supposedly promote development. Furthermore, freedom itself, whether political or economic, is an objective of development. It doesn't make sense, and for most it isn't even desirable, to enjoy a certain measure of prosperity, but to suffer repression at the same time. For liberals enjoyment of freedom, and the opportunities it provides, is part and parcel of the concept of “a just world.”

Liberals prefer liberal democracy to other forms of rule and as a means of enhancing liberty and well-being

Liberals have a problem with democracy when democracy is used to enact illiberal policies and to undermine freedom. Nevertheless, democracy, when accompanied with institutions that protect and promote freedom, is the preferred alternative. The struggle for democracy is an integral part of a larger struggle encompassing both the achievement of greater prosperity and greater freedom. Liberals have always sought to establish democracy for lack of alternatives and have always struggled to implement their vision of democracy, liberal democracy.

There is no evidence to show that democracy is bad for the economy or for economic development for that matter. Indeed, the evidence points in the other direction. The overwhelming part of the world's wealth, almost 90 %, is generated in countries that are democratic. At the same time, as we have witnessed progress in the establishing and deepening of democracy, we have also witnessed acceleration of world GDP. This is not an accident. Today's average long-term growth rate in the OECD is higher than it was for the same countries in the 100-year period before the second world war. No-one would claim that these countries are less democratic today than they were before.

Liberal policies promote economic well-being for all

That liberal policies lead to more inequality and more unemployment is a myth that needs to be destroyed. There is little real evidence to this effect. Indeed, if this were the case, we would need to explain

- why the trend in employment statistics in relatively liberal economies is an upward one
- why those countries with less liberal economic policies tend to suffer higher unemployment rates or
- why income differences in relatively wealthy liberal economies are never as high as in many poorer countries.

One explanation is often overlooked: Entrepreneurs look for new markets for their products and services. They benefit from new and growing markets. Growth is achieved through expanding markets, ie, through deepening or widening them. Markets can only be widened if there are more consumers. More consumers and more marginalisation don't fit together.

In this brief publication I have tried to assemble thoughts and evidence showing that

- liberal policy constitutes a consistent whole and cannot be divided into good policy, eg, on human rights, and bad policy, eg, “neo-liberal economic policy”
- liberal economic policy has good effects on policy in other areas, in particular on social policy

- liberal economic policy is good for growth and development and, indeed, promotes both.

These are not new ideas. Nevertheless, it is good to return to them and ponder a while about them for two important reasons:

- In everyday political life the grand or overall picture is often lost. Details tend to mask or deflect from essentials.
- The liberal model is still an unpopular one, misrepresented by conservatives and socialists alike and misunderstood. The anti-globalisation movement sees liberalism, especially liberalism in the economic sphere, as its main enemy. There is no lack of anti-liberalism in the world. The occasional corrective can do a lot of good¹.

The “third way” is a move towards liberalism and not an alternative to liberalism

The liberal model has gained support. This was especially true in the period immediately after the so-called velvet revolution of 1989–1990. But the euphoria and optimism of the

1 A comment by David Henderson: “The fact is that economic liberalism as such has no solid basis of general support. In most if not all countries, majority opinion remains hostile to the idea of what is termed ‘leaving it to the market’, and still ready to accept and endorse a much wider role for governments than economic liberals would wish to see. There is no sign that this situation, which historically has been the norm, is now about to change” (*The Changing Fortunes of Economic Liberalism*, London: Institute of Economic Affairs, 1998, p. 81).

early 1990s has subsided and sometimes given way to the scepticism and distorted message of the anti-globalisers: only the fittest benefit from liberalism.

Looking more closely at the arguments presented, many turn out to be little more than shadow boxing. If redistribution of wealth leads to the enrichment of privileged parts of the population, there is no reason for anyone, including liberals, to be happy. Similarly, it cannot be in anyone's interest to check growth and hence diminish opportunities for overcoming poverty.

Correcting misrepresentation is an important task. In Germany in 1999 we saw a bizarre discussion within the *Social Democratic Party* in which many criticised the supposedly neo-liberal thrust of the joint statement released by British Labour Party Prime Minister Tony Blair and his German counterpart, Chancellor Gerhard Schröder,² a document that declares “two decades of neo-liberal economic *laissez faire* are over” and supports the idea that the “state must become an active agent for employment,” ignoring the fact that this is what west European states have been trying to do since the second world war. We should perhaps ignore the question as to whether the document is neo-liberal or not and ask a more interesting one: has neo-liberal policy achieved better results than social democracy? The US and Irish job miracles have been mentioned and there is a lot of

2 Europe: *The Third Way*, 9 June 1999 (text available on the Labour Party website: www.labour.org.uk).

further evidence to show that liberal economic policy is good at producing jobs. The criticism of neo-liberalism is a smoke-screen masking more important fundamental questions: is redistribution really a central issue if the effect of redistribution is to slow down growth and make it more difficult for lower income groups to overcome poverty and become more prosperous? Is the objective to increase the income of lower income groups through growth or to confiscate a part of the income of wealthier citizens and thus undermine the incentives for entrepreneurial activity?

Notwithstanding the debate between social democrats and liberals on economic and social policy, we do have a consensus of historical import:

- Command economies and social engineering do not work and
- redistribution in so-called welfare states has reached its limits.³

The proposal to discuss a “third way” is little more than an attempt to jettison ideological ballast and to come closer to liberal positions using a little cosmetic surgery for the benefit of one’s own supporters.

Liberals argue that redistribution is usually inefficient and tends to produce unforeseen und undesirable results. Whenever the market is tampered with, the outcome is dis-

3 See *Europe: The Third Way*, op. cit.

tortion, misallocation of resources, waste and corruption. Things often have to be put right, leading to ever more intervention with more of the same effects.

I have argued that economic freedom is an integral part of a citizen's freedom as a whole. The free market is the expression of and depends on economic freedom. The concept of economic freedom has been defined in detail by various think tanks measuring and studying its effects. **The evidence that an economy with a high degree of economic freedom produces the best results both in terms of prosperity and performance is overwhelming.**

Economic freedom and other aspects of freedom enhance each other

The relationship between economic freedom and other forms of freedom is quite clear. There are few states in this world that are wealthy and have an extremely bad human rights record. The same can be said for the relationship between a) wealth and freedom (which is hardly surprising if freedom is understood as the total of civil liberties and political rights) and b) between wealth and democracy. There are poor democracies and poor countries with relatively high standards in the field of human rights. But there are next to no wealthy countries without democracy and without good human rights records.

Of course, when liberals talk about democracy, they are not talking about any kind of democracy, but about a democra-

cy that protects and enhances freedom and a democracy that delivers prosperity.

The economic failure of most dictatorships and authoritarian regimes is a major factor explaining the demand for more democracy and the progress towards democracy at an international level. Less obvious is the effect of economic progress in generating a demand for democracy. Wealth alone is obviously not enough for people enjoying the fruits of economic progress. Democratic participation becomes a means for securing and protecting wealth.

It is also clear that it is not formal democracy that produces good economic outcomes. The successful economies of this world, excepting cases such as Singapore and the Gulf states, are fully-fledged liberal democracies. The characteristics of such democracies such as rule of law and respect for human rights, property rights included, are important criteria for a company deciding whether or not to invest. Contemporary interest in good governance as a precondition of successful development is little more than an increased interest in liberal democracy.

The links between democracy and economic performance exist at other levels as well. When we talk about democracy, we mean participation. Participation seems to enhance accountability and responsibility. If we are directly responsible for decisions affecting our economic well-being, the decisions we make are likely to be well-considered. We looked at a few examples of direct participation: direct democracies

and participation in development projects. There are many more examples of the beneficial effects of participation on performance: eg, parents' committees in schools, shareholders in companies.

How far liberal economy policies and various political liberties and civil rights interact with one another when they are looked at separately was not a subject of this publication – but it is certainly a fruitful further field of study. Four examples: a precondition for offering commercial services via the internet is freedom of information. A precondition for a successful software business is the protection of property. A precondition for investing in transport infrastructure is the right to travel. A good system of roads doesn't make sense if citizens are not allowed to leave their towns. A precondition for successfully finding collateral for investment in the case of many poor people in developing countries is legal recognition of the right to own the dwellings they inhabit.⁴

It is no accident that a well-developed market economy is always to be found in a fully-fledged democracy but rarely in any other system of government.

Liberal policies produce good social outcomes

Acceptance of the fact that a free market, freedom and democracy mutually complement and support each other

4 See Hernando de Soto, *The Mystery of Capital*, New York: Basic Books, 2000, for a full discussion of this last-mentioned subject.

does not necessarily produce support for free markets and the policies that promote economic freedom. Perhaps the most important criticism of liberal economic policy is that it does not per se eliminate poverty and promote social justice. I haven't attempted to discuss what social justice, fairness or equity is – because ideas on the subject differ so radically. Every individual, man, woman, entrepreneur and worker, and every interest group, church, farmer lobby and trade union, has his/her/its own specific approach and understanding of such terms. The fact that there are so many attempts to impose one's own view of what is just onto other stakeholders in society using the political process certainly has negative effects on economic freedom. They include massive transfers and regulation in the name of creating an environment for "fair competition." In the process resources are squandered and opportunities destroyed.

Redistribution and regulation are not the means with which to combat poverty either. There is little evidence to show that economic intervention produces better outcomes in terms of poverty alleviation and jobs. Indeed, the greater laissez faire implied by economic freedom seems to produce better results throughout the world. We should, in this context, also remember that poverty in wealthier countries is a relative term, eg, an income half or less than the average, and has little in common with the abject poverty of the poorest developing countries.

It is useful to check our perceptions of reality against reality itself, whether what we think is happening is in fact happen-

ing. One common perception is that rapid economic growth tends to benefit the richer parts of society more than the poorer ones. The comparative data that exist suggest otherwise:

- There seems to be a link between high levels of development and a relatively “equitable” distribution of wealth. It is difficult to ascertain, however, whether or not equitable distribution is a function of wealth or the result of policies that are put into effect once a certain level of wealth has been achieved.
- States that have achieved very high rates of growth in recent times often seem to have a relatively “equitable” distribution of wealth when compared with others. Countries with large disparities between rich and poor are rare in this category. Many countries, however, in which the differences between rich and poor are very small, have a record of poor economic performance. This may be the result of government intervention that is good for distribution of wealth but bad for the economy.

The so-called tiger economies of Asia have been successful by using rather than opposing market forces. Not redistribution but the creation of opportunities has opened up the path towards rapid economic growth. Transfers mean less economic freedom and less economic freedom, as we have seen, is bad for growth. Politicians should always remember that growth is good for all income groups in society even without redistribution. The evidence, as we have seen, points in this direction.

The “first way” is the best way forward

The elimination of poverty and the creation of opportunities are important objectives of liberal policy. Poverty and lack of opportunity are indicators of a lack of freedom. Liberal economic policy, properly pursued, is the way forward – because in the long term it produces the best results. The overhasty manipulation of economic processes by the state undermines both.

The way forward is not the “second way” prescribed by socialists. It is not the “third way” that tries to repair some of the faults inherent in the second. It is the first, the original path followed by liberals. Implementation of policies that enhance freedom – introducing and strengthening free markets, establishing liberal democracy and realising basic rights – will eventually bear fruit. There is no evidence to show that the alternatives on offer will ever do so in a sustainable manner.

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