Democracy and Development: A Complex Relationship

by

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I

Most of us, ardent democrats all, would like to believe that democracy is not merely good in itself, it is also valuable in enhancing the process of development. Of course, if we take a suitably broad concept of development to incorporate general well-being of the population at large, including some basic civil and political freedoms, a democracy which ensures these freedoms is, almost by definition, more conducive to development on these counts than a non-democratic regime. We may, however, choose to look at freedoms as potentially instrumental to development, as is usually the case in the large empirical literature that aims at finding a statistical correlation between some measure of democracy and some measure of a narrower concept of development (that does not include those freedoms as an intrinsic part of the nature of development itself).

I have in general found this empirical literature rather unhelpful and unpersuasive. It is unhelpful because usually it does not confirm a causal process and the results often go every which way. Even the three *surveys* of the empirical literature that I have seen come out with three different conclusions: One by Sirowy and Inkeles (1991) is supportive of a negative relationship between democracy and development; one by Campos (1994) is of a generally positive relationship; and the one by Przeworski and Limongi (1993) is agnostic ("we do not know whether democracy fosters or hinders economic growth").[1] The empirical literature is generally unpersuasive because many of the studies are beset with serious methodological problems (like endogeneity of political regimes to economic performance, selection bias, etc.) as Przeworski and Limongi carefully point out, and problems of data quality. For these and other reasons I am not a great fan of cross-country regressions, even though the easy availability in recent years of "cleaned-up" international datasets and of the hardware and software for statistical processing have made them a favorite pastime for many of my colleagues in the profession.

In this paper I shall use the more old-fashioned methods of comparative-institutional analysis to understand the mechanisms through which democracy may help or hinder the process of development, occasionally drawing upon the contrasting development experience in largely authoritarian East Asia and democratic South Asia over the 1960's, 1970's and the 1980's. Everyone, of course, knows that over these three decades average economic performance, both in terms of per capita income growth and broader indicators like the human development index, has been substantially better in the former region than in the latter (this is also the case in the bilateral comparison of the two largest countries in the world, one in the former region and one in the latter: China and India). Yet it is possible to argue that authoritarianism may be neither necessary nor sufficient for fostering the institutional mechanisms behind the differential economic performance; it is the purpose of this paper to begin to probe the relationship (or the lack of it) between these mechanisms and the nature of political regime, in a way that may not be apparent from a simple cross-country aggregative statistical correlation.

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[1] In their more recent empirical work Przeworski and Limongi (1997) conclude that political regimes do not differ in their impact on the growth of per capita incomes, if we treat population growth as endogenous to the regime.

We should also mention that although in our subsequent analysis we shall not try to define democracy with any great precision, it is useful to keep a distinction between three aspects of democracy: one relates to some basic minimum civil and political rights enjoyed by citizens, another to some procedures of accountability in day-to-day administration under some overarching constitutional rules of the game, and another to periodic exercises in electoral representativeness. These aspects are of varying strength in different democracies, particularly in the few developing countries where democracy has been sustained over some period. On the other hand, a few authoritarian countries may display some degree of administrative accountability at certain levels of government, and may also have periodic renewals through acclamatory or referendum-style elections.

II

It is a staple of the new institutional economics and the law and economics literature that a basic pre-condition of development is a minimum legal and contractual structure and a set of well-defined and enforced property rights; the general presumption in this literature is that democracy is better-suited in providing this environment. But I agree with Przeworski and Limongi (1993) when they say that "the idea that democracy protects property rights is a recent invention, and we think a far-fetched one." If the majority are poor, and the democratic processes work, the property rights of the rich minority may always be under a threat. Of course, democracy may be ideologically more hospitable to a rule of law, but it is the predictability rather than legal accountability that is really at stake here, and it is not always clear that an authoritarian regime cannot provide a framework for a predictable set of contracts. Over the last three decades, for example, the first family in Indonesia or the KMT leadership in Taiwan has provided a reasonably predictable and durable (even though corrupt) contractual environment for private business to thrive, without the procedural formalities of a democracy. On the other hand, in some democratic regimes in spite of the existence of an admirable legal-contractual structure on paper, the courts (and the administrative arbitration machinery) are hopelessly clogged and, under the circumstances, the businessman values his connection with a durable politician much more than the legal niceties. The durability of a politician may vary wildly from one democracy to another (in one the incumbent legislator may have the edge, as in the U.S., in another the electorate may be more inclined to 'throw the rascals out' with regular frequency (as in India), and also from an authoritarian regime to another (one may be more coup-prone than another).

It should also be pointed out that the rule of law that a democracy is supposed to uphold does not by itself preclude that the laws themselves may not be conducive to development. Even in some of the richest democracies of the world while the *enforcement* of laws may be better and subject to less corruption and arbitrariness than in developing countries, the process of *enactment* of those laws is subject to an enormous amount of influence peddling for contributions to campaign finance and other perquisites for legislators. Over time this problem has got worse in most democracies, as elections have become frightfully expensive. When policies to be legislated are up for sale to the highest contributor to the campaign fund, development projects may not win out (the policy decision in the budget may go in favor of buying one more military aircraft rather than 100 rural health clinics), and it is not much consolation to be told that the policies thus legislated will be implemented well by the bureaucracy and the court system under a democracy. Of course, in an open polity there may be more avenues for mobilizing public pressure against covert (but not always illegal) sales of public policy.

Not all cases of public pressure that democracy facilitates help development either. Democracies may be particularly susceptible to populist pressures for immediate consumption, unproductive subsidies, autarchic trade policies, and other particularistic demands that may hamper long-run investment and growth. On the other hand, authoritarian rulers who may have the capacity to resist such pressures may instead be self-aggrandizing, plundering the surplus of the economy. In fact, historically, authoritarian regimes come in different kinds, some deriving their legitimacy from providing order and stability (like that of Franco in Spain or SLORC in Myanmar more recently), some from rapid growth (like Park Chung Hee in South Korea). Sah (1991) has argued that authoritarian regimes exhibit a larger variance in economic performance than democracies.

The East Asian success story in development over the 60's, 70's, and 80's has convinced many that some degree of insulation of the bureaucracy, in charge of formulating long-run development policies and guiding their implementation, from the ravages of short-run pork-barrel politics is important; the role played by powerful semi-autonomous technocratic organizations like the Economic Planning Bureau in South Korea and the Industrial Development Bureau in Taiwan clearly points in this direction.[2] It is claimed that authoritarianism made it less difficult for the regimes in East Asia to sustain this insulation. Of course, one can point out that authoritarianism is neither necessary (even in East Asia, postwar Japan has successfully insulated parts of the bureaucracy without giving up on democracy), nor sufficient (even in East Asia, the dictatorship of Marcos in the Philippines is an

[2] It is interesting to note, however, that contrary to one of the articles of faith among macro-economists, the central banks in East Asia (including in Japan) never enjoyed much insulation. Yet this lack of autonomy does not seem to have interfered with their following generally a rather conservative monetary policy. (The same is true for India.)

obvious counterexample, not to speak of authoritarian regimes in many other parts of the world) for such insulation.

Among the enabling conditions for insulation in East Asia Evans (1995) emphasizes the Weberian characteristics of internal organization of the state like highly selective meritocratic recruitment and long-term career rewards for members of the bureaucracy. Such Weberian characteristics are present to a reasonable degree in the upper echelons of the Indian civil service, but over time the democratic political process has eroded some of the insulation. This is evident particularly in political decisions on transfers of civil servants: powerful politicians who cannot sack you can make life unpleasant for you by getting you transferred to undesirable jobs and locations. In Latin America in general the appointments in the bureaucracy are more often matters of political patronage. Geddes (1994) in an analysis of the obstacles to building state capacity in Latin America shows how in the recent history of that continent the political leaders have frequently faced a dilemma between their own need for immediate political survival, buying political support with patronage in appointments to economic management positions, and their longer-run collective interests in economic performance and regime stability. In India as well administrative appointments outside the main civil service, like those to the boards of public sector corporations particularly in provincial governments, are often used as political sinecures to keep clamouring factions happy.

A more disturbing sign of politicization of the internal organization of the government in a democracy is indicated by the systematic erosion of the institutional independence of the police and the criminal justice system that is slowly creeping in some states of North India in a way that is familiar from Sicilian politics under the Christian Democrats. A significant number of elected politicians in these states are crime bosses or their accomplices, who have figured out that once elected on a ruling party ticket they can neutralize the police who will not press or pursue the criminal charges against them with any alacrity. Given their organizational and financial resources these bosses have an edge over other politicians in winning elections, and the poor often are dedicated voters for them as they nurse their local constituency assiduously even as they loot from the system in general. Another example of the exposure of the administrative system to the marauding forces of populist politics is provided by the widespread presumption among the borrowers (both rich and poor) from government-owned or controlled credit institutions in many countries that they can default on loans with impunity, as the politicians who have to depend on their votes cannot afford to let bank officials be too harsh with them. This has been one of the major reasons for the massive failures of state intervention in credit in developing countries.

In the recent literature on the role of the state in economic development[3] the issue of insulation or autonomy of the state has been formulated in terms of the notion of the ability to credibly precommit familiar from industrial economics. The ruler in a ‘strong’ state[4] is taken to be a Stackelberg leader: he maximizes his objective function subject to the reaction function of the ruled and in this process internalizes the economic costs of his impositions in accordance with that reaction function. In contrast, one can say that the ‘weak’ state is a Stackelberg follower; it cannot commit to a particular policy and merely reacts to the independent actions of the private actors like special-interest groups. Thus it is easy to see that compared to the strong state, the weak state will have too much of undesirable interventions

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[3] See, for example, Bardhan (1990, 1996) and Rodrik (1992).

[4] In any empirical exercise to explain growth performance in terms of state ‘strength’ in this sense, one has to be careful to avoid a selection bias. It is quite possible that economies in their most successful phases have less political conflict (most groups are doing well without political exertion, and the few losing groups are bribed) and therefore their governments have an appearance of ‘strength’; their commitments are not challenged or reversed by political action. This is an important issue that needs to be examined with detailed historical data. The determined way the South Korean state has handled various macroeconomic crises, say, in the seventies (the two oil shocks, massive foreign debt, inflation, etc.) suggests to me that the Korean state’s ‘strength’ is not just a reflection of the success of the economy.

(creating distortions in the process of generating rent for lobbying groups), and by the same logic, will have *too little* of the desirable interventions[5] (as may be necessary in the case of all kinds of market failures or the more general case of coordination failures), since the state does not take into account or internalize the effects of its own policies.

Elster (1994) has argued that to be credible and effective, precommitment requires democracy. The promises of a ruler are much more credible if there is a well-established procedure for throwing the ruler out of office for failure to keep those promises. "To be effective, power must be divided." This is a central theme of much of the recent work on constitutional political economy. Similarly, North and Weingast (1989) have cited the historical case of the Glorious Revolution in England in 1688, which by strengthening political institutions that constrained the king enhanced his commitment to securing private property rights and thus fostered economic growth.

I am not fully convinced by this argument. Democracy is neither necessary nor sufficient for effective precommitments. Let me illustrate this in the context of development by taking the case of infant industry protection, which has been popular in developing countries, as it was in the early stages of industrialization in the U.S. and Germany. At the time when such protection against foreign competition is usually initiated, by the very nature of the argument for temporary protection, it is granted for a short period until the industrial infant can stand on its own feet. But in most countries infant industry protection inevitably runs up against the time-inconsistency problem. When the initial period of protection is about to expire, political pressures for its renewal become inexorable, and in this way the infant industry soon degenerates into a geriatric, protection lobby. Given the

[5] While our distinction between the strong and the weak state is thus qualitatively similar to the distinction Olson (1993) has drawn between the ruler as a 'stationary bandit' and as a 'roving bandit', he overlooks the case where the latter may have too little of desirable interventions.

concentration and visibility of benefits from the perpetuation of this protection and the diffuseness of its costs, there is little organized popular pressure in a democracy against it. No conniving leader faces dismissal on this ground, making constitutional provisions for throwing out the ruler largely irrelevant here. Thus well-established procedures of democracy are not sufficient for credible commitments.

The most successful cases of infant industry protection in recent history have taken place under some of the authoritarian regimes of East Asia, particularly Taiwan and South Korea. There have been some remarkable instances in these regimes of the government holding steadfastly to its promise of withdrawing protection from an industry after the lapse of a preannounced duration, letting the industry sink or swim in international competition.[6] Democracy was not necessary to establish credibility of commitment. In fact there is evidence now that with the recent advent of democracy in these countries, some of the earlier commitments of their governments have become weaker (as, for example, in the case of the promised withdrawal of protection of small manufacturing enterprises against competition from the *chaebols* in South Korea).

If market competition in general, and international competition in particular, is important in the development process, as a disciplining factor on productive efficiency and as an inducement to cost and quality consciousness, it is necessary to examine the role democratic institutions play in the management of conflicts that inevitably arise from the disruptions and dislocations in social and economic life that market competion brings in its wake. It has sometimes been claimed (for example, in the Italian and Iberian fascist writings in the 1920's and 1930's, or in the postwar studies on corporatism) that the state for the sake of such conflict management may need to structure interest representation in society, coopting and controlling unruly

[6] For an example of how the government in Taiwan imposed an import ban on VCR's in 1982 to help out two of the main domestic electronic companies, and withdrew it after barely eighteen months when they failed to shape up to meet international standards, see Wade (1990).

elements, monitoring and containing demands so that they do not get out of hand. Such corporatist regimes usually tend toward authoritarian practices, but the latter are not strictly necessary as the history (until recently) of centralized wage bargaining in the open economies of democratic Scandinavia, or of industrial policy in the small European states Katzenstein (1985) has written about, amply demonstrates. But the initial conditions in the latter countries were arguably rather special, and quite different particularly from more heterogeneous and unequal societies.

The general theory of bureaucracy suggests[7] that it is difficult to devise high-powered incentive contracts for civil servants on account of what is called a ‘common agency’ problem (i.e. the civil servant has to be the agent of multiple principals), and under low-powered incentives for civil servants their ‘capture’ by the special interest groups is considered very likely. To the extent an authoritarian regime provides a more unified line of command, the common agency problem may be somewhat less severe. Of course, political corruption may be larger in autocracies with centralized bribe collection (‘one-stop shopping’) from the interest groups by the ruling gang. Rasmusen and Ramseyer (1994) have modelled a coordination problem[8] in bribe collection in democratic polities: they use a coordination game among wealth-maximizing legislators to show that if the latter cannot coordinate their actions, the equilibrium bribe amount for ‘selling’ private-interest statutes will be lower than in the case of an autocrat, even if the cost of corruption for the politicians under the two regimes is kept the same. In some actual democratic polities such coordination problems are reduced by committee systems, disciplined factions and party political machines. It is reported that in postwar

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[7] See Wilson (1989), Tirole (1994), and Dixit (1995).

[8] The essential problem is due to an externality that each democratic legislator’s vote potentially imposes on every other legislator, when they cannot coordinate their votes to demand a bribe which compensates them for that externality.

Japan the Liberal Democratic Party (particularly its so-called Policy Affairs Research Council, where important policies were made and pay-offs were coordinated behind closed doors) has been quite successful in centralizing bribery.

Coordinated corruption may, of course, have less adverse consequences for resource allocation efficiency than uncoordinated corruption, as Shleifer and Vishny (1993) have suggested (comparing corruption in Communist Russia with that in the post-Communist years), since in the former case the bribee will internalize some of the distortionary effects of corruption. It has sometimes been suggested that corruption in countries like South Korea may have been more in the form of lump-sum contributions to the President's campaign slush fund, without taxing economic activity at the margin, thus having least distortionary effects. The important question here, however, is how the ruler can credibly promise to keep the contributions lump-sum, and not come back again for quid pro quo deals at the margin.

The autonomy of the state has other costs in terms of economic efficiency. Bureaucratic insulation makes it difficult to attain flexibility in dealing with changes in technical and market conditions (and may thus discourage risk-taking) and also in correcting wrong decisions. This flexibility has been maintained in East Asia by fostering a dense network of ties between public officials and private entrepreneurs through deliberative councils (as in Japan or South Korea) or through the tightly-knit party organization (as in Taiwan), allowing operational space for negotiating and renegotiating goals and policies, sharing information and risks, and for coordinating decisions (and mutual expectations) with remarkable speed. Such cozy government-business relations[9] are more difficult to achieve (or politically more suspect) in societies (like in South Asia) that are more heterogeneous and unequal.

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[9] In very recent years such cozy relations have been a source of problems in the financial sector in East Asian countries.

In many situations the state is neither a Stackelberg leader nor a Stackelberg follower. Neither the state actors nor the private interest groups usually have the power to unilaterally define the parameters of their action. Both may be strategic actors with some power to influence the terms, and the outcome of the bargaining game depends on their varying bargaining strengths in different situations. Set in a bargaining framework, one may begin to resolve a problem of motivation that afflicts much of the discussion on the relationship between authoritarianism and development. An authoritarian ruler may be better insulated and may have the capacity to resist particularistic pressures, but why would he be interested in playing a positive role in the development process? What's in it for him? To this Olson (1993) would answer that a rational autocrat as a 'stationary bandit' has an 'encompassing interest' in the productivity of society as a whole and will take into account the deadweight losses from unduly onerous impositions on society's productive capacity. But in this model the power of the ruler to collect taxes or rents is invariant with respect to the policies to promote productivity.

But what if some of the latter policies increase the disagreement payoffs (and hence tilt the bargaining outcome in favor) of the ruled? As Robinson (1995) has emphasized, it may not be rational for an autocrat to carry out institutional changes that safeguard property rights, law enforcement, and other economically beneficial structures, if in the process his rent-extraction machinery has a chance of being damaged or weakened. He may not risk upsetting the current arrangement for the uncertain prospect of a share in a larger pie. For some of the 'stationary bandits' in this century (the Duvaliers in Haiti, Trujillo in the Dominican Republic, Somoza in Nicaragua, Mobutu in Zaire, and so on), who systematically plundered and wrecked their economies for excruciatingly long periods, this may have been a serious consideration. In contrast, in South Korea and Taiwan initial conditions were much more favorable to the ruled (with land reforms and expansion of mass education), and one of the few ways open to the dictators to secure their position was to derive their legitimacy from ambitious programs of shared economic growth (thus shifting the whole bargaining frontier outward), that would also serve nationalistic goals like catching up with Japan and warding off the Communist threat.

III

Democracy helps development through the accountability mechanisms it installs for limiting the abuse of executive power, and provides a system of periodic punishments for undesirable government interventions in the economy and rewards for desirable interventions. (Of course, these rewards and punishments by a politician's local constituency need not be consistent with the development goals of the economy as a whole, as in the case of the durable politician who regularly brings the 'pork' home.) Accountability mechanisms are particularly important in averting disasters; in their absence major ecological damages in the ex-Soviet Union and Eastern Europe went on unchecked for too long. In 1959-61 China had the world's worst famine this century, which killed many millions of people, whereas post-Independence India, with a much lower average availability of food for the poor than China, largely avoided such disasters. Sen (1983) has commented that Indian democracy, with its free press and vigorous opposition parties, has been politically quicker in averting sporadic threats of famines and starvation deaths; but at the same time, the Indian political system, unlike the Chinese, seems to have been unable to deal effectively with endemic hunger and malnutrition. Sometimes in a democracy it seems easier to focus political attention to dramatic disturbances in a low-level equilibrium, than to the lowness of the level itself.

Checks and balances in the allocation of control rights and standards of transparency and auditing ('institutionalized suspicion') associated with the democratic process keep gross abuses and wastes under control. If there is a public complaints mechanism is in place, a democratic regime, other things remaining the same, may generate too many complaints (since the penalty for complaints is usually relatively[10] low), and thus leading to too much screening and the consequent delay of projects, compared to an authoritarian regime where complaints may be more risky. Of course, in many democracies public scrutiny particularly of high officials is constrained by laws regarding official secrecy (like the Official Secrets Act of 1923 that the Indian government inherited from the British) and the difficulty auditors always face in disentangling malfeasance from sheer incompetence (the rules of punishment are quite different for the two, and in the case of the latter often non-existent in insulated bureaucracies). Checks and balances in a bureaucracy often involve a multiple veto power system. While this system inevitably involves delay in decision-making, it is supposed to keep corrupt officials in check. One high official in New Delhi is reported to have told a friend: "if you want me to move a file faster, I am not sure I can help you; but if you want me to stop a file I can do it immediately." This ability to 'stop a file' at multiple points creates its own opportunities for corruption and makes the process more uncertain and thus costly. A multiple veto system also has an inherent bias toward rejecting too many good proposals (or what is called Type I error) and inhibiting against risk-taking in general.

Of course, the type of a decision-making structure in economic administration is not uniquely related to the nature of political regime; a democratic public administration may be organized as a centralized hierarchy, whereas an authoritarian ruler may choose to organize his economic administration up to a certain level as

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[10] Whistleblowers losing jobs are not infrequent in democratic regimes.

what Sah and Stiglitz (1986) would call a polyarchy (used here not in the sense of Dahl, but that of a system with parallel independent decision-makers). In a situation of highly imperfect information the desirability of even uninformed central control varies, as Bolton and Farrell (1990) show, according to the relative importance of private information and the need for coordination, which may vary from case to case. They also point, drawing from the literature on dynamic incentive contracts, to the importance of commitment constraints. If the central authority cannot commit to when or how much it will intervene in a long-drawn process of production, individual agents' incentives may be adversely affected: they may not undertake socially desirable investments for fear of being expropriated ex post, or they may not disclose valuable private information for fear that the central authority might use this information against them. Going back to our earlier discussion, we may note again that authoritarianism is neither necessary nor sufficient for commitment.

In developing countries where much of the economy is in the vast informal sector and dispersed in far-flung villages and small towns, the accountability mechanisms of democracy are particularly important at the local community level. Large-scale development projects directed from above by an insulated modernizing elite are often inappropriate technologically or environmentally, and far removed from or insensitive to local community needs and concerns. Rather than involving the local people and tapping into the large reservoir of local information, ingenuity, and initiative, these projects often treat them simply as objects of the development process; they end up primarily as conduits of largesse for middlemen and contractors and encourage widespread parasitism on the state.

There is, however, no one-to-one relationship between the strength of democracy at the national political level and that of institutions of accountability at the local level. In large parts of Northern India, for example, it is common to observe the serious problem of absenteeism of salaried teachers in village public schools and of doctors in rural public health clinics. The villagers are usually quite aware of the problem but do not have the institutional means of correcting it, as the state-funded teachers and doctors are not answerable to the villagers in the insufficiently decentralized system. On the other hand, in non-democratic China the local Communist Party officials have sometimes been quite responsive to local needs (at least as long as they are not conflicting with the Party's program), as the comparative study of two villages in China and India by Dr`eze and Saran (1995) show in the context of China's far better performance in the provision of primary education at the local level. (Similar accounts are available of more effective public pressure in rural basic education and health services in Cuba compared to some of the more democratic regimes in Latin America). There are, of course, many authoritarian countries where local accountability is completely absent and the situation is much worse than in North India.

Even in otherwise centralized bureaucracies the nature of institutional design for the delegation of implementation tasks to local-level agencies is not uniquely related to the nature of the political regime at the national level. Wade (forthcoming) points to interesting contrasts between the mode of operation of the Korean irrigation bureaucracy (under an authoritarian regime in the recent past) and that of the Indian, and the clearly more locally effective performance of the former. The Indian canal systems are large, centralized hierarchies in charge of all functions (operations and maintenance as well as design and construction). Their ways of operation (including the promotion and transfer rules for officials, rules designed to minimize identification between the irrigation patrollers and the local farmers, and the frequent use of low-trust management and supervision methods) and source of finance (most of the irrigation department's budget comes in the form of a grant from the state treasury) are totally insensitive to the need for developing and drawing upon local 'social capital'. In Korea there are functionally separate organizations in the canal systems. The implementation and routine maintenance tasks are delegated to the Farmland Improvement Associations, one per catchment area, which are staffed by local part-time farmers (selected by the village chiefs), knowledgeable about changing local conditions, dependent for their salary and operational budget largely on the user fees paid by the farmers, and continually drawing upon local trust relationships.

One reason why the Indian local irrigation bureaucracy is kept at arm's length from the local farmers is the constant suspicion of the 'capture' of the former by the latter. In general local democracies are supposed to be more vulnerable to corruption than the national government. One of the central results of the literature on collective action is that small group size and proximity help collective action. Collusions are thus easier to organize and enforce in proximate groups, risks of being caught and reported are easier to manage, and the multiplex interlocking social and economic relationships among the local influential people act as formidable barriers to entry into these cozy rental havens. On the other hand, if institutions of local democracy are firmly in place along with a vigorous opposition party and free press, the political process can be more transparent and the theft of funds and the sale of influence become more visible compared to the system of centralized corruption. As Crook and Manor (1994) point out on the basis of indirect but strong evidence in the case of state of Karnataka in South India, this may reduce the overall amount of money and resources siphoned off through corruption: even though there are more hands in the till, it is difficult for people to steal very much (in big central government projects, on the other hand, a single transaction can yield very large bribes). But, ironically, on account of the increased openness and visibility of the system compared to the earlier centralized system, local people believed, often wrongly, that corruption has increased.

The 'capture' problem of local democracies can have severe implications in areas with marked social and economic inequalities. There are many situations in which decentralization may leave the poor grievously exposed to the mercies of the local overlords and their malfeasance. There are certain fixed costs of organizing resistance groups or countervailing lobbies. As a result the poor may sometimes be more unorganized at the local level than at the national level where they can pool their organizing capacities. In these situations they may even be able occasionally to play pivotal roles in national coalitions and get redistributive transfers in their favor under centralized systems. In the history of the United States, for example, movements in favor of 'state rights' diminishing the power of the federal government have often been interpreted as regressive, working against poor minorities. The U.S. case also shows that in situations of inequality and decentralization of financing of local schools, etc., neighborhoods deteriorate with the secession of the rich. In developing countries advocates of 'grassroots democracy' have to be careful about these implications for the poorest sections of the population.

Under conditions of social and economic inequality expansion of democracy may also have ambiguous effects on collective action in management of the local commons (irrigation, forestry, fisheries, grazing land, etc.).[11] In many local communities, some rudimentary forms of cooperation on the commons have been sustained and enforced over generations by traditional authority structures. While there may have been some bit of a sharing ethic, the predominant social norm was often that of an unequal patron-client system, in which the powerful who might enjoy disproportionate benefits from the institutions of cooperation enforced the rules of the game and gave leadership to solidaristic efforts. As the advent of

[11] For a formal treatment of the problem of asymmetric enforcement and exit options in the context of conservation of local common-pool resources in terms of a non-coperative game, see Dayton-Johnson and Bardhan (1996).

participatory politics and social upheavals erode the legitimacy of the traditional authorities and as political and economic modernization improves the options of both ‘exit’ and ‘voice’ for the common people, these solidaristic ties loosen, social sanctions against defectors from pre-existing arrangements become less effective, and the old cooperative institutions sometimes crumble. There follows increased dependence on the state bureaucracy to carry out functions like local resource management and maintenance of local public goods which earlier used to be in the domain of locally autonomous, though hierarchical and lop-sided, organizations. Many rural communities in poor countries are now in this difficult transition period, with traditional cooperative institutions on the decline, while the new self-governing associations, based on defined rights and legal-rationalistic norms (like regular auditing of accounts or checks and balances on arbitrary use of power) are yet struggling to be born.

IV

Finally, there are some special problems for democracy and development when the groups that get more easily mobilized are not interest groups familiar from the Western theories of democracy, but are more in the nature of sectarian or ethnic groups. The costs of collective action are often lower with ethnic bonding and identity politics than in the case of interest group politics. Apart from being identity anchors in unsettled social and economic surroundings, ethnicity can serve in the context of various kinds of inter-ethnic competition as a device to segment an expanding market, create rents, and channelize the flow to particular groups. As the government has become important in economic activities, and as democratic awareness spreads out in ever-widening circles, more and more mobilized groups have used ethnicity for staking a claim in the process of rent-sharing.

This takes the form, to give examples from two democratic developing countries, of highly successful demands for large ‘backward caste’ quotas in public sector jobs and admission to higher education in India, and all kinds of preferential policy (including in business contracts and permits in the private sector) for the *bumiputera* in Malayasia. Politicians, faced with ethnic turmoil, are quick to adopt these policies as a low-cost populist strategy. But these policies, even when their immediate financial costs are low, may sometimes be costly in the long run. Systematic economic analysis of their efficiency effects in developing countries is rather scarce.

The standard efficiency argument against job quotas for disadvantaged groups is that it splinters the labor market, distorts allocation of labor between covered and other sectors, and may adversely affect the incentives for skill acquisition among members of the quota-protected group (as emphasized by Coate and Loury (1993)). But if group-specific dynamic externalities and ‘social capital’ (in the form of role models, peer group effects, job market connections, etc.) are important determinants of economic success as in the models of Benabou (1994) and Durlauf (1995), preferential policies can increase efficiency by changing the way workers are sorted across occupations and firms. In addition, if employers hold negative-stereotype views about some ethnic worker productivity, and if in such cases the return to acquiring signals of ability is low or if signals are uninformative, preferential job policies for some time can help in eliminating stereotypes and thus improving incentives on the part of the ethnic workers for skill acquisition.

To the extent preferential policies are supposed to cope with a historical handicap, their economic rationale is akin to that behind the age-old argument for infant-industry protection in early stages of development. Some disadvantaged groups need temporary protection against competition so that they can participate in learning by doing and on-the job skill-formation before catching up with the others. Some of the standard arguments against infant-industry protection are then equally applicable against preferential policies. For example, as we have noted before, the 'infant', once protected, sometimes refuses to grow up; preferential policies, once adopted, are extremely difficult to reverse. The Indian constitution stipulated a specified duration for job reservation for the lowest castes and tribes; this has not merely been extended indefinitely, the principle of 'reservation' has now been extended to a large number of other castes. Another argument against infant-industry protection is that even when the goal is justifiable, it may be achieved more efficiently through other policies. For example, a disadvantaged group may be helped by a preferential investment policy or development programs in a particular area where the group is concentrated or with preferential loans, scholarships, job training programs and extension services for its members, instead of job quotas that bar qualified candidates coming from advanced groups. Such indirect policies of helping out backward groups are also less likely to generate political resentment (particularly because in this case the burden may be shared more evenly, whereas in the case of job quotas the redistributive burden falls on a small subset of the advanced community).

Populist pressures are not unfamiliar in authoritarian regimes, but the demands for spreading the patronage more evenly are much more difficult to resist under a democracy. To the extent democratic demands for short-run inter-group equity and for carving up the market in protected niches drown the considerations of efficiency, development suffers. But there are situations where the cause of equity also helps efficiency, and we need more empirical work on this in developing countries before we can make pronouncements on one side or the other. In particular, in situations of deep distrust among ethnic groups (which characterize many poor countries) and when the ethnic composition of the electorate militates against the basic uncertainty of electoral outcome that, as Przeworski (1991) argues, sustains democracy, forms of credible commitment to inter-group equity, even going beyond the consociational arrangements envisaged by Lijphart (1977), can help development. Rent-sharing, regional autonomy and devolution of power, and political and constitutional ways of curbing the excesses of majoritarian democracy (where some groups are in danger of being perpetually excluded from power) are extremely important for social peace and preservation of the minimum underpinnings of economic development. While democracy in general can diffuse some ethnic tensions, certain forms of democracy may be more conducive to compromise, coalition-building, and coordination than other forms[12] (for example, first-past-the-post electoral rules in single-member constituencies, giving the majority party a disproportionate number of seats, can be quite damaging in ethnically divided polities).

In this paper we have tried to understand the multi-dimensional process by which democracy tends to affect the pace and pattern of development and find that not all of it is pretty or wholesome. Yet I remain an incorrigible optimist for the long-run healing powers of democracy. My guarded wistfulness for democracy may be better expressed by quoting from a recent speech[13] in New York by Adam Michnik, a veteran of the Polish struggle for democracy:

“Democracy is neither black nor red. Democracy is gray...It

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[12] For a comparative study of the electoral systems in two ethnically heterogenous countries, Sri Lanka and Malaysia, and their contrasting effects, see Horowitz (1989).

[13] Reported in the *New Yorker*, December 9, 1996.

> chooses banality over excellence, shrewdness over nobility, empty promise over true competence...It is eternal imperfection, a mixture of sinfulness, saintliness and monkey business. This is why the seekers of a moral state and of a perfectly just society do not like democracy. Yet only democracy-- having the capacity to question itself -- also has the capacity to correct its own mistakes."

Then Michnik is reported to have ended his speech with a slight stammer: "G-G-Gray is beautiful!"

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