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Behavioral Foundations of Democracy and Development

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Abstract

Since 1974 the world has experienced a "third wave" of democratization. Ensuring that these new democracies consolidate is critical to both global prosperity and peace. Unfortunately, the academic literature that might help policy-makers shape appropriate foreign assistance programs remains underdeveloped, in that it lacks strong behavioral foundations, or explanations of why people act the way they do. This paper argues that the process of democratic consolidation requires a transition from clientelistic to contractual exchange relationships. Without that transition, efforts to promote democratic consolidation are unlikely to succeed.

BEHAVIORAL FOUNDATIONS OF DEMOCRACY AND DEVELOPMENT

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BEHAVIORAL FOUNDATIONS OF DEMOCRACY AND DEVELOPMENT

Since 1974, nearly 100 states have adopted democratic forms of government. At least half of them—often referred to as "partial democracies"—are still struggling to consolidate this regime type,[1] while several others have already been overthrown or reverted back to authoritarian rule.[2] As a consequence of this volatility, democratic consolidation has become a significant topic for both scholars and policy-makers alike.

Identifying the "moving parts" that would enable policy-makers in both new and old democracies to promote consolidation has thus far proved elusive. To date, academic research on this topic has pursued largely separate political and economic tracks, which lead public officials towards very different sorts of policy recommendations. But as we will see, neither of these tracks has been built on strong behavioral foundations.

First, research on the *politics* of democratic consolidation has emphasized that democracy derives its fundamental legitimacy "from the electoral processes by which…governments are constituted," and that it is public confidence in these processes—and disdain for the autocratic alternatives—that enable democracies to survive even in the face of, say, adverse economic performance.[3] The recent upheaval in Ukraine is suggestive of this model of democratic consolidation, in which the political opposition challenged the fundamental legitimacy of that country's electoral process, and found support for its position in both the Supreme Court and the Parliament, forcing new elections.

This political orientation has also provided the basis for advice to those in Iraq who are seeking to build a democratic polity. A recent report, for example, states that democratic consolidation in Baghdad will require "the creation of political parties and the management of free and fair elections, the establishment of an independent judiciary and the effective rule of law…and the initiation of civil society."[4] In this analysis, then, the challenge of democratic consolidation lies in promoting widespread and secure participation in political life.

In contrast, a second approach emphasizes that democratic consolidation rests essentially on *economic* foundations, and that economic crisis plays a prominent—perhaps *the* most prominent—role in "triggering breakdowns of democracy."[5] Stephan Haggard and Robert Kaufman have asserted that "consolidation should hinge…on the capacity to implement sustainable growth-oriented policies,"[6] and Adam Przeworski and colleagues have gone so far as to state this as a law-like relationship: "the faster the economy grows, the more likely democracy is to survive."[7]

Again, this line of research has been drawn upon recently with respect to Iraq. For example, an adviser to the Coalition Provisional Authority, Larry Diamond of the Hoover Institution, has written that "Without demonstrable progress on the economic front, a new government cannot develop or sustain legitimacy…"[8] This research agenda, therefore, places its primary focus on the requisites of economic growth, such as human capital formation and secure property rights.[9]

The argument of this paper is that economic growth and political development are not so neatly separable, in that they share common micro-foundations. It is these micro-or behavioral foundations that must be the ultimate unit of analysis as we seek to understand the process of democratic consolidation. Building on the pioneering work of Michael Mousseau, the account I propose has its theoretical grounding in the role of *contractual* *relationships* as the essential building blocks of both economic and political institutions in consolidated democratic states (generally defined as states that have enjoyed at least two successive, peaceful elections coupled with at least one changeover of ruling political party).[10] Conversely, in the absence of such arm's length, contractual relationships, both economics and politics necessarily rely primarily on reciprocal or clientelistic exchange, which limits the scope for market-making on the one hand and nation-building on the other. *In short, the thesis of this paper is that democratic consolidation requires the transformation of economic and political relations from a clientelistic to a contractual basis.*

In a sense, the arguments presented here elaborate upon those expressed many years ago by Milton Friedman in *Capitalism and Freedom*. There, he wrote, "Viewed as a means to the end of political freedom, economic arrangements are important…The kind of economic organization that promotes economic freedom directly…also promotes political freedom…"[11] I am similarly concerned by the relationship between economic and political organization, but unlike Friedman—whose main concern was with the "macro" structures of "competitive capitalism"—i.e. the "market"—my interest lies with the micro-foundations of economic and political freedom, which are grounded on contract.

If contracting represents a fundamental institution of modern economic and political life in the advanced democratic states (the ultimate political contract being, of course, the constitution), then the question arises as to how such norms and institutions can be built and sustained, particularly in the context of emerging democracies.

For his part, Francis Fukuyama has argued that the essential building block of democracy is "social capital," which he defines as "shared norms or values that promote social cooperation." Fukuyama asserts that "social capital is critical for successful democracy…Social capital is what permits individuals to band together to defend their interests and organize to support collective needs…If liberal democracy will be the context in which most developing countries try to enact economic policy and stimulate growth, then social capital is critical to the strength and health of that political framework."[12]

But, as I will show, social capital is a two-edged sword, and can also be part of the problem as new democracies seek to consolidate. Specifically, social capital—which is often formed, for example, on the basis of bonds of religion or ethnicity, and which defines itself in terms of "the other"—can favor clientelistic over market-based exchange. Fukuyama is certainly correct in asserting the central importance of cooperative norms in shaping the terms of political and economic development, but if democratic consolidation is to take place within diverse societies, it would seem that the norms of social cooperation cannot reliably be grounded primarily on ethnic or religious identification. As a consequence, we are brought back to the fundamental importance of arm's length contractual relationships, which permit cooperation to take place among persons who otherwise would not interact for lack of trust.

This paper is in five sections. In the following section, I develop the concept of contractual relationships and explain its importance for economic and political development. In the second, I provide some arguments with respect to how such contractual relationships might emerge, building on notions of Smithian growth.

Following that, I address issues of development policy, before turning to the role of the state. I end with some suggestions for further research.

Contracts and Development: A Preliminary Inquiry

Economics describes two, distinctive types of transaction relationship. The first, "reciprocal (or gift) exchange,"—or what I will also refer to, following the political science literature, as clientelistic arrangements—consists of "informally enforced agreements to give goods, services, information, or money in exchange for future compensation in kind." Reciprocal exchange is normally "personalized," in that it exists "between people who know each other well."[13] Reciprocal or clientelistic exchange is most often associated with "primitive" or kinship societies, where the primary ties that bind in matters both economic and political are familial, religious, and ethnic, and where distrust of outsiders is acute.

In developing world societies that are based on kinship or clannish ties, the differences among social groups can be so rigid as to impede economic growth, since transactions are principally conducted among a relatively small group of people. There is, by definition, no room in this tightly-knit system for market expansion. Political power is also based upon these same kinship ties, and patrimonial leaders use their positions of authority to dispense jobs, credit, and other benefits to one group, while denying these goods to others.

The second type of transaction relationship, powerfully associated with more developed nations, is contractual in nature, and it differs from clientelistic or gift exchange in several important respects, with significant consequences for economic growth and the political system. Adapting from Mousseau, contracts can be characterized in the following terms:[14]

First, contracts are legally binding agreements, and thus they require enforcement mechanisms, like judicial systems, in order to be effective. Indeed, contracts—and the related institutions for enforcing them—are integral parts of the same technology, and the presence of one induces a demand for the other. Contracts, property rights, and political institutions are therefore inseparable.

Second, contractual exchange is entered into voluntarily, as opposed to clientelistic exchange in which the pressures of kin or clan loom large in shaping the terms of trade. This suggests that contracts encourage personal freedom and choice, which has both economic and political connotations. As Milton Friedman once observed, history demonstrates that it is difficult to promote economic freedom while denying political freedom, though of course there are several important exceptions, like Chile during the regime of General Augusto Pinochet, and like China and Singapore today. Whether authoritarian governments are durable in the face of increasing economic freedom, however, is a question of considerable theoretical and policy significance.[15]

Third, contracts for the provision of goods and services are usually "anonymous" or "arm's length," meaning that any random buyer should expect to receive more or less the same deal from any random supplier. Unlike clientelistic arrangements, all potential parties to a contractual agreement are treated equally, with internet purchases providing the extreme example of this type of impersonal but equitable exchange. Again, this has political consequences, since people who are treated equally with respect to their economic transactions tend to resent unequal treatment in their political environment.

In short, market-based exchange is defined by legal enforcement, economic freedom, and individual equity. As Mousseau reminds us, it is notable that all of these characteristics are also hallmarks of democratic political systems.[16]

From this perspective, it can readily be seen that the process of economic and political development entails a shift from reciprocal to market-based exchange. As Michael Mousseau writes: "what predominantly differentiates the day-to-day life of people in prosperous market economies from virtually all other economies is the intensity in which they regularly engage in contract forms of economic cooperation."[17]

Similar differences between contract and client-based exchange relationships are apparent in political markets as well. Philip Keefer describes political clientelism in the following terms: "First, in clientilist countries, the credibility of political promises depends on a history of personal exchange and interaction between the promisor and the promisee. Second, patrons and clients have a preference for exchanges involving goods that benefit the recipient, narrowly, rather than a broader group…"[18]

Keefer shows that in many developing countries—including many emerging democracies—clientelism is the pervasive form of political organization, often grounded, for example, on ethnic ties between patron and client. In such systems, the patrimonial leader does not seek broad political support, but instead maintains his position with the support of narrowly targeted groups. To be sure, this electoral approach also exists in the advanced industrial democracies. Still, in most of these countries, political parties are now quite broadly-based, going well beyond their class or religious-based origins in search of voters. As a consequence, their platforms and promises must have similarly broad appeal.

An approach to political and economic development that focuses on the micro-foundations of contracting compliments in important respects current theories of democratic consolidation, and most notably those associated with the classic modernization school. Modernization theory holds that democracies are more likely to emerge and to endure as incomes rise. Popularly known as the "Lipset hypothesis" (after Seymour Martin Lipset, although he credits Aristotle with the insight)[19], the observation that democracy is more likely to emerge once nations cross an "income threshold" has received empirical support from many economists and political scientists since it was first noted in the late 1950s.[20]

In his important book *Determinants of Economic Growth,* for example, Robert Barro gives the Lipset hypothesis unequivocal support based on his detailed and sophisticated regression analyses (indeed, these have become known as the "Barro regressions."). Barro shows that GDP per capita, education levels, and life expectancy are highly significant predictors of democracy and civil liberties, "firmly establishing the general link between democracy and the standard of living."[21] Policy-makers have also embraced this conclusion, and as long ago as the early 1960s, President John F. Kennedy could claim "economic growth and political democracy can develop hand in hand."[22]

Income growth not only promotes the transition to democracy, but it also appears to help sustain nascent democracies. In a recent study, David Epstein and colleagues have found that young democracies which enjoy real growth in GDP per capita are "more likely to stay democratic."[23] In this context it is notable, from a policy-oriented perspective, that the primary objective of the new aid-giving agency of the United States, the Millenium Challenge Corporation (MCC), is economic growth, again suggesting that policy-makers also believe in a linkage between growth and democratic consolidation (it should be emphasized that the MCC only provides aid to countries that "rule justly").

Unfortunately, while the empirics of the Lipset hypothesis seem relatively strong, the theory underlying it remains less so. Barro himself has written that "theoretical models of the effects of prosperity on democracy are not well developed."[24] A central issue in the theoretical debates concerns the precise channels through which increased prosperity influence political participation. One argument is simply that higher income levels lead to the leisure time which permits political participation, and indeed Barro calls democracy "a luxury good," like environmental or labor standards. Another view, which is found in the democracy literature going back at least to Aristotle, is that prosperity permits the population to obtain higher levels of education, which in turn promotes greater political participation.[25] Missing from these accounts are the micro-foundations that might link economic and political development in an integrated fashion.

It must be stressed that the articulation of a causal account of the effects of economic policies and processes on democratic consolidation has a distinctively policy-related rationale, beyond any academic one. After all, advancing the cause of democratization often requires not only immediate political pressures from domestic (and external) agents, but, more precisely, some knowledge of the mechanisms by which democracy can be strengthened in less direct but possibly no less effective ways. The status of economic growth and development as a potential object of universal policy consensus recommends the promotion of these goals as a particularly promising approach to democratic consolidation, since they suggest to all stakeholders the promise of a positive sum game with growing pies and bigger pieces for all, rather than a redistributive game pitting winners against losers.[26]

However, the weakness of the causal analysis of the relationship between economic development and democracy detracts from the possibility of targeting its critical micro-level "moving parts," and hence from accelerating the consolidation of young democracies. Indeed, as we will see in the following section, misguided assumptions about that relationship have led to counter-productive development policies. Discovering these "moving parts" is thus of critical importance to policy-making.

What, then, is the relationship between economic growth and political development? Building on research by Mousseau, *the underlying argument here is that it is precisely the market-based norms of contract—which encompass individual freedom, equity, the rule of law, and so forth—that also form the micro-foundations for democratic governance*. As Mousseau writes, "If norms and values tend to institutionalize, then it follows that market values favor democratic institutionalization."[27]

Conversely, "democracies without prosperous economies will tend to be unstable. The leaders of less prosperous democracies are not likely to be constrained by constituents to respect individual choice, free will, and the sanctity of the social contract. Instead, such leaders are likely to be constrained to pursue other values, such as religious norms, ethnic participation, or some sort of nationalist revanchism."[28] But this is almost a truism or tautology: to the extent that reciprocal exchange is widespread, it inevitably means that societies are fundamentally organized around such concepts as kin and clan. Political leadership in such cases means advancing the narrow interests of those particular groups, as opposed to "national interests" and "public goods." The question, then, is under what set of economic and political conditions leaders would be motivated to generate public as opposed to narrowly targeted, patronage goods.[29]

This question is particularly significant for weak or partial democracies, since one of the critical demands placed by voters upon any new democracy is bound to be the provision of a wide variety of public goods, such as education and social insurance. As Matthew Baum and David Lake have written, "we expect that democracy…will itself be an important determinant of the level of public services…"[30] That may be true, but as we will see, democracies vary in the level of public service they provide.

Various explanations for the relationship between democracy and the size of government have been given. In one set of models, democracies are associated with high levels of political competition, which dissipate the rents available for capture by politicians and special interest groups. As a consequence, "The more democratic the country, the lower the level of rents and the larger the quantity of public services provided…"[31] Other scholars have emphasized the role of the median voter in seeking redistribution from the higher income brackets, thus demanding public goods like education, health care, and social safety nets. In some of these models the median voter demands so much redistribution that incentives to investment are undermined and growth reduced.[32]

If democracies provide more public good than dictatorships—and empirical research has shown that "autocratic governments…provide public schooling, roads, safe water, public sanitation, and pollution control at levels far below democracies"—the question arises as to how this relates to the contractual approach to economic and political development.[33] The essential point is that democracies vary in both the level of public goods they provide, and with respect to who the primary recipients are. As Philip Keefer and Stuti Khemani of the World Bank write, "Even in developing countries that are democracies, politicians often have incentives to divert resources to political rents and to private transfers that benefit a few citizens at the expense of many. *These distortions can be traced to imperfections in political markets that are greater in some countries than in others"* (emphasis added).[34]

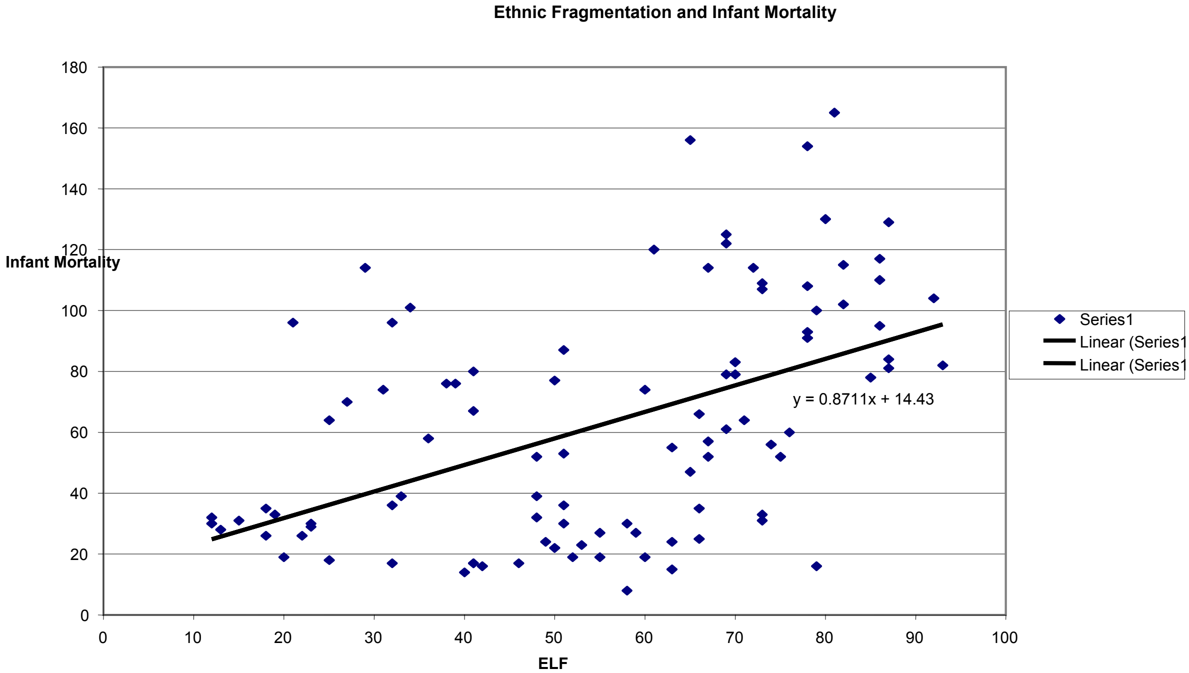
Specifically, Keefer and Khemani explain that political market imperfections—including incomplete information, lack of credibility, and social fragmentation—lead to a distribution of public goods, such as infrastructure, that supports targeted groups rather than the population as a whole. Again, we are confronted with the question of how personalistic or clientelistic exchange in politics—of the kind described by Keefer and Khemani—can be transformed into a broader-based social contract between citizens and the state.

As an illustration of the Keefer-Khemani thesis, let us examine the public goods of education and health care. Specifically, it is widely acknowledged that an important indicator of societal well-being is the rate of infant mortality; as societies become more developed, the rate of infant mortality tends to decline. Indeed, a study sponsored by the Central Intelligence Agency asserts that the infant mortality rate in a particular state "is a significant indicator of its stability."[35]

The issue that concerns us is whether the provision of public goods is influenced by the degree of clientelism within a given society, as proxied, say, by its ethnic fragmentation. Interestingly, the CIA-sponsored study cited above asserts that "a country's ethnic composition has almost no inherent impact on its odds of stability," meaning that ethnically more diverse societies are not, as is commonly supposed, more unstable. As a consequence, we would therefore expect to find no strong relationship between infant mortality rates and ethnic fragmentation.

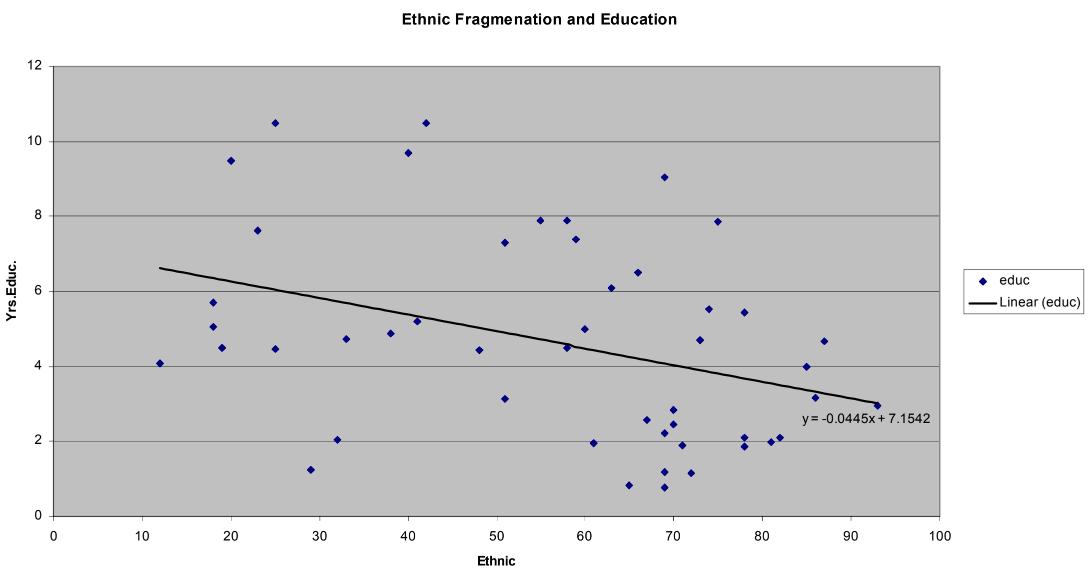
In **Figure 1,** I present the results of a simple correlation between infant mortality rates and ethnic fragmentation. As we can see, the relationship is (weakly) positive: the higher the level of fragmentation in a society, the higher the level of infant mortality (per 1000 newborns). As an additional test, **Figure 2** shows a (weakly) negative relationship between fragmentation and levels of education. These results would seem to support Keefer-Khemani regarding the availability of public goods in fragmented societies, and undermine the CIA-sponsored research, or at least put into doubt its underlying analysis; naturally, it would be useful to have disaggregated data that shows how health care or education are distributed among social groups. Overall, however, the results suggest the need for further exploration concerning the capacity of deeply fragmented states to produce public goods, and to develop broadly-responsive public institutions more generally.

Figure 1
Ethnic Fragmentation and Infant Mortality



Sources: On ethnic fragmentation, see Alberto Alesina, et.al., "Fractionalization," *Journal of Economic Growth* 8 (2003): 155-194; on infant mortality, UNDP, *Human Development Report 2004.*

Figure 2
Ethnic Fragmentation and Education



Sources: On ethnic fragmentation, see Alberto Alesina, et.al., "Fractionalization," *Journal of Economic Growth* 8 (2003): 155-194; on education see Robert Barro and Jong-Wha Lee, "International Data on Educational Attainment: Updates and Implications," *CID Working Paper* 42 (April 2000).

The Evolution of Contractual Relationships

Few questions are more significant for political and economic theory than the emergence and evolution of institutions that structure human relations. Some theorists have posited that institutions are primarily distributive in nature, reflecting the balance of economic and political power within a given society. Far from providing public goods, institutions act to maintain and strengthen given sets of power relations. In short, institutions reflect the interests of society's most powerful agents.[36]

An alternative view argues that cooperative institutions—that is, institutions which enhance transaction efficiency—arise spontaneously on the basis of repeated or iterated exchanges among individuals. In *The Wealth of Nations*, for example—which can be read as an allegory, or extended meditation upon conditions in clannish 18th century Scotland—Adam Smith famously described the process by which self-sufficient households came to participate in the division of labor, which enabled them to produce and consume more goods than they could otherwise.

For Smith, as households sought new goods and services over time, they inevitably began to trade more and more with their neighbors and with other villages (or clans). This process led to the creation of new professions, like merchants—specialized actors who were more productive in generating trading opportunities than the fully occupied farmer and fisherman. With the benefits of specialization, economies became wealthier, and every citizen profited as a result. Thus, for Smith, the wealth of nations was a byproduct of the division of labor, which released the creative energies of a people. Over time, repeated interaction led each agent to adopt a "nice" strategy that maximized his gains.[37] In this rendering, institutions—such as the contract—are mutually beneficial arrangements that help structure behavioral expectations.

Critical from the contractual perspective developed here, Smith's distinguished predecessor, Charles de Montesquieu, had already noted the profound influence of market expansion on human behavior; Albert Hirschman famously called this the "doux-commerce thesis."[38] Indeed, during the 18th and 19th century, political theorists frequently espoused the view that commerce would alter the nature of both citizen and civil society. Specifically, commerce, according to Montesquieu, "polishes and softens barbaric ways as we can see every day." What this meant, according to a textbook written in 1704, was that "Commerce attaches men one to another through mutual utility"—not, as in tribal societies, through kinship or clan ties.[39] In short, the expansion of commerce and the demand for new specialties—bankers, merchants, barristers, and so forth—led to increasing demand for "what you knew" as opposed to "who you knew," and thus to a radically different approach to social relations.

Emile Durkheim elaborated on this general perspective in his classic work, *Division of Labor in Society*. For Durkheim, the division of labor played a crucial *social* and not just economic function; it effectively supplanted the kinship or clientelist ties of primitive societies. He wrote, "If the division of labor produces solidarity, this is not only because it makes of each person an exchanger…it is because the division of labor creates among men a comprehensive system of rights and duties which tie them to one another in a durable fashion."[40]

The division of labor and the contractual relations associated with it, however, could not be relied upon to stand on their own; naturally, they demanded political institutions to ensure their stability and continuity, since men were never fully trustworthy, and might always be tempted to cheat on the agreements they had reached with one another. But what sorts of political institutions were most likely to protect the rights of individuals to the fruits of their labor? What sorts of institutions would best protect the contracts that bound men together?

These are among the central questions that social theorists have asked since the 18th century and the dawn of the industrial revolution. For many of them, including the founding fathers of the United States, the answer was clear, and it was democracy.

Understanding why they believed this to be so is not merely of historical interest, but more to the point it is most relevant to the challenges now being faced by those who are poor and oppressed throughout the developing world, as they seek to break the clientelistic bonds that impede their opportunities for development. The essential lesson of this history is that economic and political development are inextricably linked, and that the economic changes that Smith realized were necessary if growth was to be achieved had a significant institutional component as well.

Yet a more nuanced account of the relationship between economic development and democracy emerges when we consider the problem of democratic consolidation. In so-called "partial" or "unconsolidated" democracies, rulers are still likely to draw heavily on clientelistic support networks. As a consequence, a policy of, say, denying a particular ethnic group its property rights could be a politically-winning strategy. As Keefer writes, "To the extent that clientelism is more prevalent in young democracies, the political payoffs from socially beneficial…policies, such as secure property rights, are correspondingly fewer."[41]

Now we have come full circle and return to the heart of our problem, which is that the achievement of sustained growth and democracy requires overcoming social fragmentation and the clientelistic transaction relationships it necessarily breeds. But when we look at the world around us, we see that many of the nations that are in crisis also have highly fragmented societies—think, for example, of the situation in Africa, in Iraq, or in the former Yugoslavia. Building trust among different African tribes, or among Sunnis, Kurds, and Shiites, or among Orthodox Serbs and Muslim Bosniacs and Kosovars, is no easy task.

Such divisions not only limit the possibility of economic expansion, but politically these kinship groups can easily fall prey to demagogues or patrimonial leaders, their Slobodan Milosevics, to exploit societal fragmentation and the "fear of the other" that exists. As Mousseau insists, overcoming patronage and clientelism by promoting a system of market-based contracts may provide the key as to whether such societies will consolidate and succeed as capitalist-oriented democracies, or whether they will remain mired in conflict and poverty.[42] In short, developing countries need a form of "gene therapy" in which contractual genes are transformed into clientelistic ones. Encouraging that transformation is a crucial task not only for domestic reformers, but also for the international community that seeks to help them.

Development Policy and Democratic Consolidation

The global spread of democracy over the past thirty years offers the promise of a much more peaceful and prosperous world. Ensuring their consolidation should therefore be the single highest priority of the old, established democracies of North America and

Western Europe. Achieving that objective, however, requires public policies, including foreign aid policies, based on a solid understanding of how economic and political development evolves.

This is particularly important, since not all new democracies survive their political honeymoon. A perusal of the *Freedom in the World* country rankings since 1990, for example, suggests that while many if not most countries now enjoy greater political and civil liberties than they did at the beginning of the decade, there remain a significant number of states where that is not the case.[43] Some, like Pakistan, have already fallen victim to military coups. Others, like Russia, are drifting back towards authoritarian regimes. And still others, like Iraq, have futures that remain in the balance. As Barbara Geddes has shown, of the 85 authoritarian regimes that have collapsed since 1974, only 30 have become "surviving and mostly quite stable democracies…"[44] The other governments are either unstable, have already been overthrown, or have reverted back to authoritarianism by suspending elections (see Tables 1 and 2).[45]

Table 1

Some "Third Wave" (post-1974) Democratic Reversals*

- Guatemala (1981)
- Peru (1989)
- Argentina (1975)
- Ghana (1981)
- Nigeria (1982)
- Turkey (1979)
- Pakistan (1976, 1998)
- Sri Lanka (1976)
- Central African Republic (2000)
- Algeria (1992)
- Thailand (1991)
- Russia (2003)?

Source: Adapted from Michael J. Hiscox and Scott L. Kastner, "Trade Policy Openness, Government Spending, and Democratic Consolidation: A Preliminary Analysis," Paper prepared for the International Studies Association Conference, Montreal, March 2004. *Several of these cases of "reversal," such as the Thai coup of 1991, were only of brief duration.

Table 2

Some "Partial" Democracies

- Armenia
- Azerbaijan
- Benin
- Burkina Faso
- Zambia
- Cote D'Ivoire
- Malawi
- Guinea-Bissau
- Lesotho
- Gambia
- Malaysia
- Sri Lanka
- Peru
- Honduras

Source: David Epstein, et.al., "Democratic Transitions," *CID Working Papers* 101 (January 2004).

This advance and retreat of nascent democracies—and the considerable uncertainty about how best to "lock-in" democratic institutions—leads to the policy-relevant question of what sets of programs and institutions domestic reformers and the "international community" should adopt in the interest of consolidating democratic institutions.[46]

To be sure, much attention has already been paid to the role of foreign aid in promoting "civil society" and human rights, for example by funding non-governmental organizations and other institutions that contribute to the decentralization of political power.[47] In places like Ukraine, it would appear that investments in political parties and civil society have paid a handsome dividend. Yet in many other countries, civil society has had difficulty emerging, or expanding beyond its clientelistic networks.

If some of the fundamental differences between developing nations and the advanced industrial states are rooted in the degree of clientelism that exists in the former as compared to the latter, what are the implications for policy-making? Over two hundred years ago, Adam Smith suggested that the most important implication is that both economic and political development must be grounded on market expansion—expansion of opportunities to participate in economic growth and in political life.

If development requires overcoming deeply rooted social divisions, then public policies must focus on the sources of those divisions directly and not on the symptoms they generate, such as poverty. After all, poverty is not evenly distributed across social groups, but is a reflection of underlying power structures. If the foreign assistance community does not recognize and deal with these power structures, its policy efforts are doomed to fail. To put this more sharply, development requires nothing less than the breaking down of the kinship and clientelistic ties that play such a powerful role in shaping inter-personal relations in many countries around the world.

In order to attack these clientelistic networks, we need to understand what scarce and vital resources they control. These include access to such highly valued goods as personal security, credit, jobs, foreign and domestic trade, and education and social insurance, not to mention political power; in short, clientelistic networks control patronage goods. Clientelism must somehow be supplanted—often by the state—if development is to proceed, and that implies a very different approach to foreign assistance.

The most important good that kinship ties provide in many developing countries is personal security. Indeed, this is a service that Mafias also provide, usually at great expense, in some industrial states as well, particularly in places where the central government has been relatively weak, as in Russia following the collapse of communism. As the United States has learned at great cost in Iraq—but as it might have learned years earlier by observing the situation in Russia or Africa or Latin America—development cannot proceed without security that is provided by a central enforcement agency.

Indeed, in this respect President George W. Bush would have done well to remember Max Weber's definition of a state, "the agency that holds a monopoly of violence over a given territory." In the absence of state-provided security, that guarantees equal protection to all citizens, there can be no hope whatsoever for either economic growth or for democracy. Conversely, states simply cannot permit armed groups to operate without the severest of sanctions, a lesson that the Palestine Authority, for example, will someday be forced to learn.

But this implies using police and armed forces as an instrument for building up national identities, as opposed to harnessing them solely for the purpose of oppressing particular groups. And here is a case where the industrial states might have something useful to teach. The U.S. armed forces, for example, have played a crucial role in shaping modern American society, by integrating and promoting minorities within a purely meritocratic organization. Since foreign aid—at least U.S. foreign aid—is often channeled in support of military spending, these agencies could play an active role in ensuring that the state's instruments of violence are representative of the society at large, through the adoption of appropriate recruitment, training, and promotion policies. We will return to this theme of recruitment below when we consider the costs and benefits associated with foreign direct investment, which similarly tends to favor privileged groups.

Personal security also has another dimension, which is the right to enjoy one's property without fear of seizure, or the protection of property rights. In developing countries, such property rights are largely absent, and as the Peruvian economist Hernando De Soto has so powerfully pointed out, the poor often lack even legal titles to the property they possess.[48] As a consequence they fall prey to local bosses who forge clientelistic relations with them, denying them economic freedom. Providing secure property rights is also essential to market expansion, since real property is the fundamental asset that individuals use in order to obtain credit.

In fact, among the most critical resources that kinship networks control from the perspective of market expansion is access to credit. In most developing countries, credit is allocated along clientelistic lines—think of the infamous "crony capitalism" that characterized, for example, Suharto's Indonesia—so that obtaining scarce funds is truly a matter of "who you know" as opposed to "what you know." The difficulty of obtaining credit plays a significant role in limiting the access of individuals—usually from oppressed or minority groups—to education and training opportunities (in many developing countries education is private and fee-based), and of course to funds for developing or maintaining farms and businesses.

To appreciate the power of relatively open and accessible capital markets, consider the student loan program of the United States, which enables *anyone* admitted to a university to obtain funds to help finance their education. What this means is that a high school graduate no longer has to be rich to attend an Ivy League college, an incredible development that has occurred only over the last thirty or forty years. As late as the 1950s or 1960s, it was near impossible to attend Harvard or Yale if your family wasn't wealthy, and indeed these schools favored elite children from elite prep schools in their admissions policies; in short, they were clientelistic. Today, a variety of financial aid and loan schemes have greatly opened access to higher education across the United States.

The economic and democratic value of the student loan program can hardly be overstated, but again, it is a small miracle that most Americans take for granted. Foreign aid agencies can play a similarly potent role in developing countries, by providing the underlying capital needed to support micro-finance that should be targeted at a nation's "underclass." At present, there is little incentive for private sector actors to provide such funding, especially if they are powerfully associated with the "crony capital" network. Foreign aid can therefore help break these credit logjams, providing enhanced opportunities for people to participate in economic and thus political life.

Yet another function of clientelistic networks is to provide employment and income for friends and allies—think of America's famous political "bosses," like Boston's James Michael Curley, who ruled the nation's city halls for much of its history, dispensing patronage in the form of jobs at the local post office and fire station. What happened to these bosses and their machines? While the answer is surely complex, it is interesting to note that President Franklin D. Roosevelt capitalized on the New Deal and its many job programs not only to cope with the economic devastation wrought by the Great Depression, but also as a political weapon for destroying the urban bosses and their political networks, as responsibility for generating employment shifted during the 1930s and early 1940s from municipalities to the federal government.[49]

Today, public works programs that generate jobs are generally viewed by aid agencies as economic rat holes, and as a consequence fewer funds are channeled to them. But when properly designed they can serve instead as development beehives, bringing together a diverse group of people under the umbrella of the state. Adam Smith recognized this when he called upon the British Parliament to finance the building of canals across Scotland, which would draw the clans closer together, and American leaders were cognizant of broad development goals when they built the Erie Canal. Public works like Roosevelt's Tennessee Valley Authority helped break down the "feudal" political and economic relations that still characterized the American South in the 1930s, providing the modern foundations for a region that is now vibrant. These programs, that inspire and draw upon the energies of a nation, can be an essential building block of economic and political development and consolidation.

Expanding the market at home by providing security, credit, and jobs are all vital if clientelism is to be undermined, and aid can be helpful in realizing these objectives. But there is also an important international dimension to market expansion, and here, too, the industrial world has a significant role to play. After all, kinship networks often control access to trade networks, as occurs in Africa and, to a degree, in Southeast Asia. Since trade exemplifies the promise of market expansion, it seems obvious that greater openness should occupy a central place in any policy arsenal aimed at breaking clientelistic ties. Trade not only promotes economic growth by unleashing dynamic market forces, but it can lead to the creation of new, “middle class” specialties that provide the hard core of support for stronger property rights and democratic institutions. From this perspective, opening the industrial world to trade from developing countries is among the greatest contributions that can be made to economic growth and democratic consolidation. Conversely, industrial world protectionism does more damage to the development process than we can possibly imagine, and perhaps for that reason we have been slow—much too slow—in removing the high barriers to trade.

More complicated when it comes to international opening, however, is the role of foreign direct investment. On the one hand, foreign direct investment can serve as a great motor of development, through its contribution to employment, technology transfer, tax revenue, and training opportunities. On the other hand, if the multinational firm favors, for example, the existing ethnic elite in its hiring policies, then its potential benefits in terms of market expansion and democratization are undermined. That poses a tremendous dilemma for multinational executives as they ponder the effects of their investments on development, and it poses a classic inter-temporal trade-off. Whereas hiring the chief’s son may be good for business in the short-run, it may be bad for business in the long-run, as the economy fails to grow and as political institutions fail to democratize. In this case, foreign aid teams might work with multinational firms to ensure that the workforce is broadly representative of the societies where they are operating.

Neither domestic nor international market expansion can occur, nor can democracy consolidate, if populations go uneducated. Aid funds should therefore be used to bolster educational access, particularly for minority groups. Education spending and access to schooling in developing countries is strongly distributive, in that it often favors certain ethnicities and economic classes, not to mention its gender bias against girls and women. Expanding access to education can help break down the walls created by clientelism, through the formation of educated elites that will be in a stronger position to demand equal opportunity and equal rights, fundamental goods that are associated with democratic forms of government. By denying particular groups access to education, they are left, quite literally, in the dark about their political and economic opportunities, and thus lack voice with respect to the development process.

Strengthening the State

All of these policies will require a significant strengthening of the state's capacity for policy action. It is therefore ironic that the west, over the past ten or fifteen years, has unwittingly solidified clientelistic and kinship ties and weakened the state through its foreign aid and technical assistance programs. Much of aid policy, for example, has had the misguided purpose of undermining the central government's political authority by promoting the fad known as "fiscal decentralization" or "fiscal federalism," which means giving more fiscal responsibility to local authorities. This is a classic case of confounding symptoms and causes.

During the 1990s, development policy-makers came to believe that the main problem they faced was the corrupt and inefficient developing world state. The concept of fiscal decentralization was meant to correct that evil through the introduction of competition and greater accountability at the regional level. Economists generally like fiscal decentralization because they believe that competition among regions, say for investment, tends to be a good thing. Potential investors can then "vote with their feet," choosing the mix of taxes and public services that best fits their business model. Thus, to take the American case, investors can choose between chilly Minnesota with its Scandinavian-style welfare state and high taxes, or tropical Mississippi which provides fewer public amenities but also a lower tax rate.

But in countries that are divided along ethnic lines, and where kinship ties are vital to survival, people are unlikely to "vote with their feet," leaving one region for another in search of a more amenable tax environment. To the contrary, the political bosses of local regions have used fiscal decentralization to increase their relative power and control over scarce resources. Indeed, because these bosses have no incentive whatsoever to provide public goods—like fiscal stability—to the society at large, they have made it difficult for weak, central authorities to control local spending and budget deficits.[50]

Yet another, misguided foreign aid fad was "privatization" of everything from state-owned enterprises to public pensions. Again, the underlying theory of privatization was understandable in an abstract sense. State-owned enterprises were deemed to be inefficient and the subsidies they enjoyed were choking government budgets. The answer, quite obviously, was to privatize these firms, which would force them to become productive or else face bankruptcy. And an added benefit of privatization, of course, was that it would further weaken the state by denying central authorities the policy instruments associated with running public companies.

Across the developing world, this process was often subverted by a small group of insiders. Not only did they profit immensely from this asset fire sale, but they also ended up enjoying tax relief that was more than equivalent to the subsidies the firms had earlier received. Further, it proved politically impossible to bankrupt firms that provided the sole employment opportunities to people who were stranded in their regions for whatever reasons (think of the Siberian cities and industries that Stalin built), and who could not simply "vote with their feet." These experiences have taught that privatization without a strong state to regulate the process, and to allocate the profits from it to the citizenry at large, has turned out to be socially wasteful in important respects.[51]

What all this suggests is that the principal problem of development is not that of state strength *per se*, but rather it is the control of the state by a narrow group of elites who exploit it for personal gain and for the benefit of a targeted group of clients. Indeed, in most developing countries the state needs to be substantially strengthened, not weakened. The remedy, therefore, is not to decimate central authority, but rather to loosen the grasp of the clientelistic networks that control it, through the sorts of policies mentioned earlier.

To be sure, political reform is also needed. If the state is to be strengthened, then it must also be restrained. This implies some system—though not necessarily the

American system—of "checks and balances," which limits the executive's authority and potential for abuse, while also encouraging greater voice and inclusion in political life, by providing citizens with multiple points of entry. The political system of checks and balances, including the development of competitive political parties, provides the institutional compliment to the contractual society, as it stands in firm opposition to clientelism. It is therefore hardly a coincidence that this system is never found where patrimonial and kinship ties hold sway.

Can Democratic Consolidation Succeed?

Few problems are as daunting as those of democratic consolidation. The difficulties and failures that we have encountered around the world—if not actively helped to create—are undoubtedly discouraging, particularly when one loses sight of the enormous advance of democracy that has taken place over the past two decades. In the absence of an underlying theory of why things go wrong (or right) in democratizing societies, and without a vision of what needs to be done, there is little reason to place much confidence in the policy advice we might offer.

Scholarship that focuses on the conditions under which fundamental institutional change occurs—such as the transition from clientelistic to contractual exchange relationships—is sorely needed.[52] Deductive research is undoubtedly critical in this regard, but it must be supplemented by careful case study analysis of institutional change. Ironically, much of our present-day scholarship, rooted as it is in political economy models of institutions, is simply incapable of dealing with the challenge of change.

The policy payoff from elaborating development theories which go beyond historical institutionalism and incorporate the possibility of institutional change could be enormous. Around the world, millions of people seek freedom from the yokes imposed by poverty, oppression, and clientelism. Ultimately, democratic consolidation is about their inclusion in economic and political life.

Notes

[1] See David Epstein, et.al., "Democratic Transitions," *CID Working Paper* 101 (January 2004).
[2] Barbara Geddes, "What Do We Know About Democratization After Twenty Years?" *Annual Review of Political Science* 1999 (115-144).
[3] Samuel P. Huntington, *The Third Wave: Democratization in the Late Twentieth Century* (Norman, OK: University of Oklahoma Press, 1991), 258.
[4] Public International Law and Policy Group and The Century Foundation, *Establishing a Stable Democratic Constitutional Structure in Iraq: Some Basic Considerations* (New York: The Century Foundation, 2003), p. 69.
[5] See Mark J. Gasiorowski, "Economic Crisis and Political Regime Change: An Event History Analysis," *American Political Science Review* 89, 4 (December 1995: 882-897.
[6] Stephan Haggard and Robert Kaufman, "The Political Economy of Democratic Transitions," *Comparative Politics* 29, 3 (April 1997): 263-283, at 279.
[7] Adam Przeworksi, Michael Alvarez, Jose Antonio Cheibub, and Fernando Limongi, "What Makes Democracies Endure?" *Journal of Democracy* 7, 1 (January 1996): 39-55, at 42.
[8] Larry Diamond, "What Went Wrong in Iraq?," *Foreign Affairs* (September/October 2004), web edition p. 2.
[9] See Torsten Persson and Guido Tabellinin, *The Economic Effects of Constitutions* (Cambridge, Ma.: MIT Press, 2003), and Philip Keefer, "What Does Political Economy Tell Us About Economic Development—and Vice Versa?," *World Bank Policy Research Working Paper* 3250 (March 2004).
[10] Michael Mousseau, "Market Prosperity, Democratic Consolidation and Democratic Peace," *Journal of Conflict Resolution* 44 (August 2000).
[11] Milton Friedman, *Capitalism and Freedom* (Chicago, Il.: University of Chicago Press, 1962), p. 8.
[12] Francis Fukuyama, "Social Capital and Development: The Coming Agenda," *SAIS Review* XXII, 1 (Winter-Spring 2002), 23-37, at 25.
[13] Rachel E. Kranton, "Reciprocal Exchange: A Self-Sustaining System," *American Economic Review* 86, 4 (September 1996), 830-851, at 830.
[14] This definition of contract is adapted with some changes from Mosseau, "Market Prosperity."
[15] It might be argued that technological and economic change is making the combination of capitalism and authoritarianism increasingly feasible. I thank Steve Kobrin for highlighting this point.
[16] A point emphasized by Mousseau.
[17] Michael Mousseau, "Market Prosperity, Democratic Consolidation and Democratic Peace," *Journal of Conflict Resolution* 44 (August 2000), p. 477.
[18] Philip Keefer, "Clientelism, Credibility and Democracy," unpublished manuscript, World Bank, 6 November 2002, p. 4.
[19] Seymour Martin Lipset, "Some Social Requisites of Democracy: Economic Development and Political Legitimacy," *American Political Science Review* 53 (March 1959): 69-105.
[20] But for an influential dissent, see Adam Przeworksi, et.al., *Democracy and Development* (New York: Cambridge University Press, 2000).
[21] Robert Barro, *Determinants of Economic Growth* (Cambridge, MA: MIT Press, 1997), p. 67.
[22] Cited in Robert Packenham; *Liberal America and the Third World* (Princeton: Princeton University Press, 1973), p. 126.
[23] David Epstein, et.al., "Democratic Transitions," *CID Working Paper* 101 (January 2004).
[24] Barro, *Determinants of Economic Growth,* p. 52.
[25] For a classic expression of modernization theory, see Samuel P. Huntington, *Political Order in Changing Societies* (New Haven, Ct.: Yale University Press, 1968).
[26] For an elaboration of this argument, see Dimitri Landa and Ethan B. Kapstein, "Inequality, Growth and Democracy," *World Politics* 53 (January 2001): 264-296.
[27] Mousseau, "Market Prosperity," p. 479.
[28] Mousseau," Market Prosperity," p. 480.
[29] On this issue see Philip Keefer and Razvan Vlaicu, "Democracy, Credibility and Clientelism," unpublished manuscript, 2004.

[30] Matthew A. Baum and David A. Lake, “The Political Economy of Growth: Democracy and Human Capital,” *American Journal of Political Science* 47, 2 (April 2003), 333-347, at 333.
[31] Matthew A. Baum and David A. Lake, “The Political Economy of Growth: Democracy and Human Capital,” *American Journal of Political Science* 47, 2 (April 2003), 333-347, at 336.
[32] See Alan Drazen, *Political Economy in Macroeconomics* (Princeton, NJ: Princeton University Press, 2000), for a discussion and many examples.
[33] Robert Deacon, “Dictatorship, Democracy, and the Provision of Public Goods,” unpublished manuscript, University of California at Santa Barbara, July 2003.
[34] Philip Keefer and Stuti Khemani, “Democracy, Public Expenditure and the Poor,” unpublished manuscript, World Bank, April 2004.
[35] Jack A. Goldstone and Jay Ulfelder, “How to Construct Stable Democracies,” *The Washington Quarterly* 28 (Winter 2004-05), 9-20, at 14.
[36] Jack Knight, *Institutions and Social Conflict* (New York: Cambridge University Press, 1992).
[37] Robert Axelrod, *The Evolution of Cooperation* (New York: Basic Books, 1984).
[38] Albert Hirschman, “Rival Interpretations of Market Society: Civilizing, Destructive, or Feeble?,” *Journal of Economic Literature* 20, 4 (December 1982): 1463-1484.
[39] Hirschman, “Rival Interpretations,” p. 1465.
[40] Durkheim, cited in Hirschman, “Rival Interpretations,” p. 1471.
[41] Keefer, “Clientelism,” p. 28.
[42] Mousseau, “Market Prosperity.”
[43] The rankings can be downloaded as an Excel file at www.freedomhouse.org.
[44] Barbara Geddes, “What Do We Know About Democratization After Twenty Years?” *Annual Review of Political Science* 1999: 115-144, at 115.
[45] For a useful survey with more recent data of democratic stability, see David Epstein, et.al., “Democratic Transitions,” *CID Working Paper* 101 (January 2004).
[46] On this issue, see Thomas Carothers, *Critical Mission: Essays on Democracy Promotion* (Washington, DC: Carnegie Endowment for International Peace, 2004); Larry Diamond, *Developing Democracy: Towards Consolidation* (Baltimore, Md.: Johns Hopkins University Press, 1999).
[47] See Jakob Svensson, “Aid, Growth and Democracy,” *Economics and Politics* 11 (November 1999): 275-297.
[48] Hernando De Soto, *The Mystery of Capital* (New York: Bantam Press, 2000).
[49] See David R. Colburn and George E. Pozzetta, “Bosses and Machines: Changing Interpretations in American History,” *The History Teacher* 9 (May 1976): 445-463.
[50] See Erik Wibbels, “Federalism and the Politics of Macroeconomic Policy and Performance,” *American Journal of Political Science* 44 (October 2000): 687-702.
[51] For further elaboration of these points see Oliver E. Williamson, “The New Institutional Economics: Taking Stock, Looking Ahead,” *Journal of Economic Literature* 38, 3 (September 2000), 595-613.
[52] For a promising example, see Avner Greif and David Laitin, “A Theory of Endogenous Institutional Change,” *CDDRL Working Papers* 15, Stanford University, 19 November 2004.