Democracy Comes Second

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Democracy is slowly spreading around the world. From the Middle East to Latin America and Asia, many autocracies are taking gradual steps towards more democratic and accountable forms of government, or have become fully-fledged and well functioning democracies. The US administration is determined to consolidate political freedoms in many developing countries under its sphere of influence; indeed, expansion of democracy has become a cornerstone of American foreign policy.

There are many reasons to celebrate the current democratic wave. Democracy is associated with less injustice and abuse, with basic civic and political freedoms, and with greater sensitivity by governments for the true priorities of its citizens. But how important is democracy for economic success?

Not much, the empirical evidence suggests. This might appear surprising. After all, is it not true that virtually all rich countries have democratic forms of government, while the poorest countries (mainly in Africa) are non-democracies? Indeed, throughout the world, democracy is strongly correlated with higher per capita income.

But this correlation goes missing when one looks at the dimension of time rather than space. Countries that become democracies do not, on average, achieve faster economic growth after their political transition; and, vice versa, democracies that fail and relapse into autocracy do not, on average, do worse than before.

The positive correlation between income and democracy that one sees across countries could be due to reverse causation: democracy is more likely to persist as a country grows richer. It could also be due to special historical or cultural circumstances: some societies are just more successful than others, both in terms of economic development and with regard to their ability to develop and maintain democratic political institutions.

Whatever the reason for the observed positive cross-country correlation between income and democracy, it should not be confused with causality. Being democratic does not seem important in securing economic success.

Of course, there are many different kinds of democratic transitions, and lumping them all together might be misleading.

An important distinction in practice concerns the interaction between the economic and the political system. A democracy born in an open economic environment, with a well functioning market system, widespread foreign direct investment, and sizeable international trade, is likely to consolidate economic liberalism, stabilize expectations, and hence lead to more investment and faster growth. Conversely, if an economy is tightly controlled by the state, has protectionist barriers against foreign imports and capital movements, or relies on rents from exhaustible resources to obtain foreign currency, transition to democracy can be plagued by populism and struggles for redistribution, hurting economic growth.

Empirical evidence supports the idea that the success of a democracy depends on the openness of the underlying economic system at the time of political transition. In the post-WWII period, the more successful episodes of democratic transitions have been preceded by widespread economic reforms that extended the scope of the market and facilitated international integration. Examples include Chile and South Korea in the late 1980’s and Mexico in the mid-1990’s.

Conversely, when democratic transition was attempted in a fragile and closed economic environment, the outcome was much worse. This applies to the episodes of democratization in Latin America and the Philippines in the mid-1980’s, but also to Turkey in the early 1980’s and Nepal in 1990. The contrast between China and Russia also fits this pattern very well.

China first opened its economic system to the rest of the world, and only now is it thinking (a bit too slowly) about political reform. Russia instead jumped into democracy, and only then worried about replacing socialism with a market system. There was probably no other way to do it in Russia, but the Chinese path seems much more likely to lead to lasting economic success.

This does not mean that democracy is unimportant. But the sequence of reforms is critical for successful economic development, with economic reforms coming first. When an open and well functioning market system is in place, democracy has a much better chance to lead to lasting prosperity.

An important reason for this is that, in order to create a successful market system, the state must respect basic individual rights: the rule of law, private property, and the enforcement of justice. These fundamental rights are part and parcel of democratic government. But when it comes to economic development, these fundamental rights are more important than other purely political aspects of democracy, such as universal suffrage and genuine political competition.

This is how the Western world became democratic in the nineteenth and twentieth centuries. Economic liberalism came first, political liberalism later. But today’s young democracies have to do everything much faster. They don’t have the luxury of restricting suffrage to property owners, or to more educated citizens.

Nevertheless, we should remember the lessons of history. Political reforms are more likely to be successful if they are preceded by economic reforms. We should insist that Egypt or Pakistan improve their market system, apply the rule of law, and open their economies to international trade and capital movements. Allowing free elections and true political competition is also critically important, but this should follow economic reforms, not precede them.