

# DEMOCRACY AND ECONOMIC DEVELOPMENT

Economic development is an outcome of the interaction of social, political and economic institutions. These institutions are inextricably linked with each other and shape the structure of the economy. Hence, each of them assumes importance in the economic development of the country.

The classical political economy beginning with Smith's ideas focused upon the how well functioning of the market leads to favourable outcomes in the society. They examined the economy vis-à-vis the role of the state. According to them, market, left to itself, delivers best results. For them, self-interested individual decision makers in pursuit of their goals contribute to maximization of aggregate well-being of the nation. The state should, thus, play a minimal role. The institutionalists pay attention to the role of institutions in the performance of the economy. The basic problems of an economy are what to produce, how to produce and for whom to produce. Thus, the basic problems of an economy centre around how resources (both human and physical) are properly allocated and how the fruits of growth are properly distributed. This emphasizes upon inclusive development or growth. It is universally acknowledged that market is the best way to organize economic activities and government can sometimes improve market outcomes. The nature of functioning of market, therefore, determines the economic development of the country. This is because market allocates resources, distributes income and determines the size of the economy in terms of GDP (growth) and level of employment. It is the mode of production that determines the size distribution of income. Ronald Harry Coase, in his seminal works in 1937 and 1960, emphasizes that a well-defined property rights, minimum transaction cost and rightly enforced contracts can lead to best market outcomes, such as the allocation of resources in the economy. A well functioning market, thus, requires that property rights are properly defined and enforced, contract is enforced and the transaction cost is minimum. It is in the above contexts that the role of institutions in economic development is important. The New Institutional Economics, the critique of the mainstream neo-classical economics gave importance to the role of institutions determining the economic performance. According to the New Institutional Economics, markets function properly only if the institutions are good. Douglas C. North defines institutions as the humanly devised constraints that shape human interaction. Institutions create incentives. The incentives are necessary for economic performance of a nation. Good institutions enforce property rights, help in minimising transaction costs and enforcement of contracts that are essential for the economic development of a country. Good institutions overcome the principal-agent problem and the problem of moral hazard. There are mainly three types of institutions: social, economic and political. North distinguishes formal and informal institutions and according to him, they evolve or change over time. Informal institutions, mainly the social constraints, take a long time for change but formal institutions are subject to frequent changes. Formal institutions are created by the government or the authority upon which the governance is vested. The government, therefore,

is responsible for good political and economic institutions. Such institutions are the rules of governance and economic policies. The best form of governance can ensure prevalence of good institutions. Therefore, the best form of government is needed for a country to prosper.

There are many forms of government, such as, democracy, monarchy, dictatorship, etc. of these, democracy is considered as the best form of government. According to Abraham Lincoln, “Democracy is a form of government of the people, by the people and for the people.” Democratic form of government creates strong political and economic institutions that promote economic development. Following are the important features of a democracy:

1. Universal adult franchise. This means right to vote is vested with the citizens of the country who have attained a statutory minimum age.
2. Election of representatives by the people. That means, people are ruled by themselves through their representatives.
3. Responsible government. This implies government is accountable for the smooth administration and governance of the country. This ensures transparency in governance.
4. Equity and inclusiveness
5. Efficiency
6. Civil liberties. In democracy, civil liberties, such as, right to expression, right to protest, right to organize, equality of opportunities, etc. are granted to the civilians.
7. There is rule of law in the democracy. The laws are enacted in the constitution.
8. Public opinion is considered important in a representative democracy.

Democracy has three organs of government, such as, legislature, executive and judiciary. Legislature enacts rules and laws. Executive comprising bureaucrats organized in a line of hierarchical positions execute the rules enacted for the welfare of the citizens and the country. Judiciary protects and safeguards laws. That means it ensures that the laws and rules enacted are not violated at any level and ensures punishment for violation. Democracy also gives importance to freedom of press. These democratic institutions create well-defined property rights and enforce them. This helps in economic development.

In this context, understanding property rights, its role, violation and enforcement are essential. Besides, there is a need to understand the terms contract enforcement and moral hazard. ‘Property rights’ is the right to own, use and transfer property. A well-defined and secure or protected property rights is necessary for good functioning of the market mechanism. In an adverse situation, suppose that an agent apprehends that his or her property is likely to be stolen or expropriated he or she will have no incentive to participate in economic activities. Similarly, a well-defined contract minimizes transaction costs and contributes to the better functioning of the market. It also creates incentive. It is the duty of the government to ensure that the property rights are well-protected and contracts are well-accomplished through

minimum transaction costs. Thus, the roles of three organs of the democratic government are important to ensure enactment and enforcement of property rights and proper enforcement of contracts. A democratic political institution can be successful to achieve all these requirements.

Acemoglu and Robinson distinguish extractive and inclusive institutions. For them, it is necessary for a state to promote inclusive institutions. Inclusive institutions create incentives whereas extractive institutions create disincentives. In “The Economics of 38<sup>th</sup> Parallel” in their thought provoking book ‘Why Nations Fail’, the authors have deliberated the present state of the two neighbouring economies, North Korea and South Korea that were created out of the parent country Korea in the aftermath of the Second World War. The path breaking work also elucidates the reason for the difference in the nature of development in two distinct nations. After the war, the North Korea was ruled by USSR socialist regime whereas the South Korea was ruled by the capitalism harbored United States. The study shows how the two distinct and polarized economic systems caused the difference in the magnitude and quality of development of two neighboring countries. In North Korea no ownership title over property was vested with the citizens. Whatever they earned was the nation’s property and they didn’t enjoy freedom to have and use the property. But, in the South Korea, the US capitalistic model proved good for the country where right to own and use the property was protected or guaranteed. This created the incentive to invest and simultaneously created an environment which attracted foreign investment. As a result the country flourished and maintained a flying geese pattern of growth setting the example of ‘East Asian Miracle’. The standard of living of the people of the country boosted up amazingly. However, the North Korea witnessed a continued depletion in living standards. This shows how the mode and organization of production affect protecting property rights and create chaos.

Thus, a good government emphasizing upon the inclusive institutions can perform best. Democracy can have best performance in terms of economic development by ensuring freedom of expression, freedom of choice in opportunities (i.e., where to utilize or invest property), responsible government, accountability of people, transparency, adequate participation of people, inclusiveness and rule of law. It can perform well in proper allocation of resources and distribution of the fruits of growth in the economy. However, the nature of development in the democratic country depends upon several factors, such as whether the institutions are properly practiced or not. This is what we call safeguarding property rights. The legislative, executive and judiciary should perform in an unbiased manner to protect the rights of the people, or else the situation will be adverse. Biased governance leads to moral hazard and is detrimental to economic prosperity.