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Democracy, Capitalism and Development

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ABSTRACT

In social science, a passionate debate continues about the expected effect of democracy on development. Many authors believe that democracy dampens development. This paper discredits this view by clarifying the debate's critical conceptions - democracy, capitalism and development. In the non-communist state, private individuals inspire economic development, because they own the major portion of the nation's resources. Since individuals are selfish by nature, they ordinarily improve their economic welfare if they enjoy 'fair freedoms' meaning that the social environment of fair freedom is the key to economic development in the non-communist state. Capitalism guarantees this environment, which suggests that the desirable functioning of capitalism is the clue to economic development. Democracy is the only system of governance that can guarantee long term peaceful functioning of the capitalist economy. Thus, a nation cannot remain poor if she is governed according to the principles of democracy.

Introduction

Democracy, a very ancient word, has two important usages. In the popular sense, it signifies a political system in which the political part of government is elected through adult suffrage. From the academic viewpoint, democracy refers to the theory of a political system, which assumes that people are the owners of the sovereign power of the state, who rule, and are ruled simultaneously, by electing their deputies. On the other hand, development is a very recent concept that points to the performance of an economy. Accordingly, a higher development index implies better socio-economic progress and vice-versa.

Since the political system controls the economic system, the performance of an economy basically measures the performance of the controlling political system. For quite sometime, a passionate debate has been going on in social science literature about the expected impact of democracy on development. This debate, which originally started in the political science and sociology literature in the 1950's and the 1960's, has now captured the economists' attention.

One group of social scientists in this important debate, strongly believes that democracy dampens development. This view was most forcefully stated in the American Economic Association's (AEA) symposium on "Democracy and Development" held in 1993:

"Academic fashions often follow the public political mood. In a period when euphoric public commentators have announced 'the end of history' in the triumph of capitalistic democracy one sees an increasing number of scholarly studies attempting to show, often on the basis of cross-country statistical evidence and a bit of wishful thinking a positive effect of democracy on development. It is in this context refreshing to see the agnostic results reported by Adam Przeworski and Fernando Limongi in their paper. On the basis of their review of the theoretical arguments and statistical studies they conclude rather bluntly: 'We do not know whether democracy fosters or hinders economic growth' (Bardhan, 1993 p.45)

For at least two good reasons, this academic assertion provokes both criticism and scepticism. First, two ethical issues - how to live and how to rule - have been at the centre of social investigation since the dawn of human civilization. Yet, centuries of experience and intellectual investigations have produced no universal model. However, a compromise seems to be emerging about adopting democracy as a desirable political model for the current world order, particularly after the collapse of communist regimes in the former USSR and Eastern Europe. Since economic development is the ultimate goal of modern politics, the view - democracy dampens development - suggests that this emerging compromise is founded on a shaky theoretical base. In other words, academicians seem to be at crossroads with politicians. Second, communism is apparently no longer an option to guide national and international political affairs. If this proposition is accepted, then the

above academic assertion leads to a serious inference - the natural alternative to manage national and international political affairs is a sort of non-communist dictatorship, which will evidently promote capitalists' interests throughout the world.

Assuming that democracy is the desirable political model for the current world order, the curious question that deserves serious intellectual investigation is whether the theory of democracy contains natural and social elements helpful to promoting economic development. An affirmative answer to this question has the potential not only to refute the charges antagonists have laid out against democracy, but also to end the head-on collusion between western academicians and politicians. This paper intends to supply this answer by clarifying the conceptions of democracy, capitalism and development and pinpointing their expected associations.

Democracy: Theory of a Political System

Our search for a pivotal perception of democracy might begin from ancient Athens - the most important place where democracy was first practised. In Aristotle's words, the fundamental features of Athenian democracy are as follows:

"The foundation of the democratic constitution is liberty. People constantly make this statement implying that only in this constitution is there any share in liberty at all; every democracy, they say, has liberty for its aim. 'Ruling and being ruled in turn' is one element in liberty. Then there is the democratic idea of justice as numerical equality, not equality based on merit; and when this idea of what is right prevails, the people must be sovereign, and whatever the majority decides that is final and that is justice. For, they say, there must be equality among citizens." (Aristotle 1967, pp 236-37).

Equality, sovereignty and liberty - all of which refer to voters - are thus the three fundamental features of democracy, which may be stated as its principle, premise and objective: The fundamental principle of democracy is numerical equality of the voters, not equality of merits. This principle, in turn, leads to the fundamental premise that people are sovereign authority of the state. Finally, the sole objective of democracy is to protect and promote voters' liberty.

Athenian democracy was direct democracy, because the popular assembly, which consisted of all voters, was the ultimate authority to make decisions concerning government activities. Today's democracies are called indirect or representative democracy, since elected politicians make all kinds of decisions in public institutions. This difference in decision-making raises a critical question: Does the current model of representative democracy retain the fundamental principle, premise and objective of the Athenian or direct democracy?

The origin of today's democracy may be traced back in a single idea that John Locke develops in his famous classic, *Second Treatise of Government*. This idea is the 'right to rule'. In civil associations, no one is supposed to manage others' affairs without their consent. This is particularly true in the execution of governmental activities, because this function involves imposing laws, rules and regulations on individuals that restrict their freedoms and might even harm their personal interests.

Locke establishes his 'right to rule' theory on the conception of social contract. The theory starts with a basic assumption - individuals used to live in the state of nature that was ruled by the law of nature. Since there was no common civil authority in this state to execute natural laws, each individual acquired executive power to punish those who transgress their liberties. However, the transgressors could not be punished if they were stronger than their victims. To overcome this inconvenience of the state of nature, individuals surrender all their natural and social liberties - powers as well as possessions - to form civil society. In Rousseau's (1968, p.61) words, fundamental features of this contract are as follows:

"If, therefore, we set aside everything that is not essential to the social pact, we shall find that it may be reduced to the following terms: Each one of us puts into the community his person and all his powers under the supreme direction of general will; and as a body, we incorporate every member as an indivisible part of the whole."

This act of association, Rousseau says, creates a moral and collective body called, civil society that bears the name republic or body politic. It is called the state when passive, the sovereign when active, and a power when compared with the likes. The associates collectively take the name of people and are individually called citizens as participants in exercising the sovereign authority, and subjects, for being bound by the laws of the state.

Government is no party to this contract, because the contract is among numerically equal voters. However, civil society, or the sovereign, needs its own agent to unify it and give it effect following the directions of the general will or public good. The institution of government is this agent. It is simply 'an intermediate body set up between subjects and sovereign to ensure their mutual correspondence, and is entrusted with the execution of laws and with the maintenance of liberty, both social and political'.

This short survey brings in sharp focus the key ideas of the theory of democracy: All theories of political systems are concerned with locating the sovereign authority of the state: In monarchy, God is the true source of all powers. Therefore, God is the sovereign authority of the state and monarchs are His representatives. In Marxism, dictatorship of the proletariat is the state's sovereign authority. In democracy, this authority lies with voters. This premise requires that voters be assumed as numerically equal, which, in turn, makes protecting and promoting voters' liberty as the state's fundamental function.

In direct democracy, the logical agreement among these ideas is obvious. However, the system of indirect democracy makes them questionable, because elected politicians run government machinery. Voters have little control over them after the suffrage, which raises two critical questions about indirect democracy. The first one is how to retain the premise of voters' sovereignty. Without this premise, the method of changing the political part of government through elections cannot be described as democratic. The second is how to make elected politicians accountable to voters, because the voters are not involved in the execution of governmental functions. The requirement of retaining voters' sovereignty necessitates the formulation of the social contract theory, because this contract is among numerically equal voters, not between the ruler and the ruled. When people (voters) become sovereign, government becomes a deputy, meaning that politicians responsible for running government businesses are accountable to their electorate. From this it follows that the fulfilment of the first requirement implies the fulfilment of the second. It may thus be inferred that direct and indirect democracies differ only in institutional terms, not in their theoretical features.

Capitalism: Theory of an Economic System

Those who argue that democracy dampens development firmly believe in the virtue of capitalism to create economic affluence. This pattern of argumentation seems controversial, because capitalism is the economic system of the non-communist state whose most popular political system is democracy. Thus, the argument that democracy is an inappropriate political model for creating affluent society is tantamount to the suggestion that this model is inconsistent with capitalism, implying that the conception of capitalism is another main source of controversy in the democracy-development debate.

The state is a political association, whose main function is to define and defend citizens' civil rights. Of all kinds of civil rights that the state is responsible to define and defend, the institution of private property is most crucial. Based on the nature of this institution, all states may be grouped into two classes - communist and non-communist. In communism, economic resources are owned almost exclusively by the state. Consequently, the state is responsible for providing the means of living to its citizens. The economy, which is created by this type of property ownership, is called socialism. In the non-communist state, citizens are allowed to own and accumulate private property, for which private individuals own the bulk of the nation's economic resources. The economy that is created by the mixed ownership of nation's resources is described by various terms depending upon the major modes of production. According to Marx, there are five major modes of production, which describe the historical development of production relations in different societies - primitive-communal, slave-owning, feudal, capitalist and socialist, the first phase of communist (Kozlove, 1977). The first and the last modes of production refer to the communist state, while the other three describe production relations in the non-communist state.

The main concern of this paper is capitalism, whose theoretical foundation was laid down by the Scottish philosopher Adam Smith in 1776 in his famous classic, *An Inquiry into the Nature and Causes of Wealth of Nations*. His main motivation in writing this book was to discredit the prevailing theory of economic policy - mercantilism. The core of this trade theory is that favourable trade balance is both desirable and essential for national prosperity. Therefore, government should regulate foreign trade to increase the inflow of specie in the country by discouraging the importation of manufactured goods through heavy custom duties and encouraging the exportation of domestically manufactured goods by exempting from such duties. This theory clearly suggests a dual trade policy to benefit at the expense of the trading partners, for which it is described in the economic literature as 'beggar thy neighbours' policy.

Smith saw some serious defects in this doctrine. First, mercantilism is a very unfair trade policy meaning that it cannot be a guide to develop trade relations among independent nations. Second, the primary objective of this protectionist trade measure is to increase the inflow of specie. Since the improvement in national prosperity requires increase in capital, this policy cannot contribute to economic development, because money (specie) and capital are not the same. However, the most critical weakness of this theory is that it completely overlooks private individuals' role in national prosperity of the non-communist state. Since private individuals own the bulk of the nation's economic resources, economic policy of the non-communist state must be consistent with human nature. The gist of Smith's theory, which harmonizes two conflicting facts of social life - selfishness and national prosperity - may be stated as follows: Individuals are selfish by nature. With respect to economic activities, some individuals find great pleasure in creating and accumulating private wealth. If these individuals are allowed to pursue their selfish endeavours, they will promote their own economic welfare, which will eventually lead to the material progress of whole society. For, the 'invisible hand', now understood as the competitive market mechanism, will force selfish economic actors to use their resources efficiently. The passage that is most often quoted from the *Wealth of Nations* in this regard, is the following:

"It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their self-interests; we address ourselves not to their humanity but to their self-love and never talk to them of our own necessities but of their advantages" (Smith 1939, pp 26-27).

This is the idea of an affluent economy of the non-communist state that Smith formulated in the *Wealth of Nations*. He did not describe his model as a theory of capitalism. It was Karl Marx who popularized his theory as capitalism. Marx believed that the institution of private property was the main source of all evils in human society. Guided by this conviction, he formulates the theory of historical materialism or the materialistic interpretation of history, which describes the ultimate cause and moving powers of all important historical events in economic development - changes in modes of production and production relations, the consequent

division of society into distinct classes and the struggle among these classes (Engels 1991). From this theory, Marx predicts the eventual collapse of capitalism to the final mode of production in human history - communism - whose first phase is socialism. This collapse, however, is not natural; this collapse is to be carried out by the proletariat revolution through overthrowing the bourgeoisie system of government to win the state's political power.

It may be noted that Marx did not question capitalism's wealth - accumulating power; he was clearly convinced about this power. What he criticized and detested is capitalism's exploitative nature. In theory, capitalism is founded on a system of equity which says that returns to all factors of production are determined the principle of perfect competition. Perfect competition, however, is mostly a scenario and very seldom a situation, meaning that capitalism is a highly exploitive economic system in reality. This is, perhaps, well understood by many analysts. What they object is the solution that Marx has suggested - elimination of the institution of private property by establishing proletariat dictatorship: "... to achieve its emancipation, the proletariat must overthrow the bourgeoisie, win the political power and establish its revolutionary dictatorship" (Lenin, 1991, p. 225). This is, however, a very different story that is no concern of this paper. The point relevant for this paper is that there is no real distinction between political and economic systems in the communist state; the state is the owner and user of nation's economic resources.

Apparently then, all sorts of confusion in the democracy-development debate come from the non-communist writers. And the real reason of these confusions is their failures to distinguish the roles political and economic systems play in the non-communist state. First, democracy and capitalism are often treated as synonymous ideas. The AEA's symposium, quoted at the beginning of the paper, may be taken as an example. The phrase, capitalistic democracy, used in many studies, reflects this confusion. Second, in democracy, people are assumed to be the sovereign authority of the state and government as their deputy. There are, however, studies that treat government as sovereign (Przeworski and Limongi 1993). This is certainly a very wrong perception of democracy, which has inspired empirical studies that equate democracy with elected government and use these statistics to empirically measure the relation between democracy and development. Thus, America and Argentina, Britain and Bangladesh are all democratic countries!

Development: Performance of Public Administration in Democracy

Development is the final confusing conception in this critical debate, which has different dimensions. First, the protection of property rights is a precondition for economic affluence in the non-communist state. Some non-communist writers are sceptical about the fulfilment of this precondition in democracy: “The idea that democracy protects property rights is a recent invention and we think a far-fetched one” (Przeworski and Limongi 1993, p.52). This inference has been drawn by combining both communist and non-communist views. Democracy is founded upon the principle of numerical equality of voters. Since the bulk of voters in the non-communist states are poor, the minority property owners might feel threatened in their pursuit of accumulating wealth in a democracy. Thus, the nineteenth-century non-communist writer Thomas Macaulay (1900) argues that universal suffrage implies the end of property and therefore, the end of civilization. From a very different perspective, Marx insists that private property and democracy are incompatible. In other words, democracy and capitalism are inherently unstable forms of social organization, because universal suffrage unchains class struggle.

Then, there are Marxist writers who describe democracy as a modern concept or a concept of modernity (Amin 2001). They understand modernity, which dates from the Age of Enlightenment, as the adoption of the principle that human beings, both individually and collectively, are responsible for their history. This Marxist view has been articulated to expose the inconsistency in the arguments of the Western non-communist writers. After World War 2, when the Cold War between the East and the West intensified, influential Western governments supported many civil and military dictators in the third world arguing that “democracy is a ‘luxury’ that could come only after ‘development’ had solved the material problems of the society” (Amin 2001, p.11). This Western view changed radically after the collapse of communism in the former USSR and Eastern Europe.

However, the main source of confusion in this debate seems to emanate from the failure of understanding the process of economic development of the non-communist state. This is perhaps the result of misunderstanding the meaning and message of Adam Smith’s path-breaking articulation of the link between human nature and public policy. As noted above, Smith’s main inspiration to write the *Wealth of Nations* was to discredit the mercantilist’s beggar thy neighbours’ trade policy. He showed that freer trade policy would cause national wealth to accelerate, because selfish producers would use their resources more efficiently and a liberal trade policy would inspire international specialization of resources.

The ideas that Smith wanted to impress upon intelligent minds are now well established: unqualified protectionism is not a desirable trade policy of an independent state - politically or economically. The creation of affluent societies in the North justifies Smith’s economic wisdom that individuals should be given ‘fair freedoms’ to pursue their economic

ambitions. The practice of communism of over a half-century, and its eventual surrender to the Western democracies, gives credibility to his wisdom.

This, however, raises questions about why the countries of the South, which have adopted a democratic form of government, are not developing in the expected manner. The apparent logical answer is that citizens of these countries do not enjoy 'fair freedoms', a phrase that signifies allowing individuals to enjoy liberty according to the principle, premise and objective of democracy described above. In other words, the socio-economic and political environment in which individuals enjoy 'fair freedoms' does not exist in the South, meaning that the creation of this environment is the appropriate policy response to dealing with the South's poverty problems. This measure, in turn, implies the creation of proper law and order, elimination of unnecessary government interference, and the establishment of corruption-free public administration etc. The term 'good governance' is used in the current development discourse to signify this environment. In other words, good governance is the solution to the South's hydra-headed development debacles.

In short, good governance refers to the desirable performance of public administration in democracy, which facilitates desirable functioning of capitalistic economic system. And if the system of capitalism works well, a country that pursues a democratic system of governance cannot continue to remain poor for long, meaning that economic development is the desirable performance of public administration in democracy. The slow pace of economic development in the third world countries is being caused by 'bad governance', not at all due to some significant defects, as are often suggested by some, in the theory of democracy.

Conclusion

The above discussion shows a harmonious relationship among three critically important conceptions, which lies in the centre of the democracy-development controversy. Economic development in the non-communist state is inspired by private individuals, because they are the major owners and users of a nation's economic resources. Individuals are naturally propelled to improve their economic welfare when they enjoy 'fair freedoms'. Capitalism is the economic system in which they enjoy fair freedoms - i.e. to pursue their economic ambitions. Thus, the key to economic development in the non-communist state is desirable functioning of its economic system, capitalism. And, democracy is the only system of governance of the non-communist state that can guarantee peaceful and long term functioning of the capitalist economy.

This line of reasoning raises a critical question concerning the implication of the view that democracy dampens development. The proponents of this view firmly believe that capitalism is the model of economic affluence. If democracy does not help capitalism, then other political models of the non-communist state, including dictatorship, do. In other words, this view seems to suggest some kind of autocratic regimes for the governance of

the Third World countries. Even if the moral tastes of politics in sovereign nations is ignored, questions remain as to how can autocratic regimes inspire development since they cannot guarantee long-term peace and stability in society?

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