



# GOVERNING FOR PROSPERITY

## Book Governing for Prosperity

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### Recommendation

Why do some nations thrive while others seem trapped in a cycle of poverty, instability and corruption? The 14 contributors to this anthology agree on one answer to this question: the rule of law. While the developed West spends billions of dollars promoting democracy in developing nations, the authors suggest that democracy itself does not bring about prosperity. In terms of economic growth, stability and predictability are more important than democracy, they argue. As evidence, they contrast wealthy authoritarian regimes like Singapore with poor and corrupt democracies like India. Some readers might find the implications of such conclusions alarming. That's all the more reason to read this book, which *BooksInShort* recommends to anyone with an interest in economic development, public policy and the global political order.

### Take-Aways

- Successful societies require a secure political order.
- Order is a political good that must be carefully constructed.
- Focusing solely on market reform or on the instruments of democracy is not enough to help a transitional state move onto the path of development.
- Poverty, hunger and disease are the preventable products of reversible institutional and political failures, not the result of ignorance or inevitable natural forces.
- Political arrangements create incentives for leaders to foster growth or to steal their nations' prospects for prosperity.
- Length of political tenure is usually inversely proportional to the rate of economic growth.
- Large, voting blocs reduce the threat of non-constitutional challenges.
- Economic growth can be maintained even during political instability.
- The rule of law is a more important factor in economic growth than democracy.
- Governmental aid to impoverished countries with corrupt leadership should move through private channels.

### Summary

# When Bad Economics Are Good Politics

The war between socialist and capitalist economies is over, and despite the grand victory of market economies, vast portions of humankind still live with the daily tragedy of hunger, poverty and disease.

These conditions persist because the structure of governments and their political arrangements produce a wide range of results. Either they create incentives for political leaders to foster the growth of their nation or they establish incentives to steal the wealth, instead. The question of how to govern for prosperity is likely to be the most important policy puzzle of the 21st century.

Economic growth results not from the work of civic-minded citizens, but from the construction of political institutions that provide leaders with an incentive to take care of their citizenry.

Dictators and their equivalents are immune from the effects of recessions and downturns, whereas democratic leaders constantly have to make effective public policy and avoid economic crises. Perhaps this is why Saddam Hussein is still in power and George Bush (senior), arguably a nicer guy, was thrown out of power.

## Resilient Dictators

Dictators - with alliances and theft-distribution deals with their government's militia - have an easier time maintaining their power for obvious reasons. Throughout much of the world, governments provide neither peace nor prosperity. In many of these countries, longevity of leadership inversely correlates with policy performance. More democracy doesn't necessarily mean more economic growth.

“Politicians can't be expected to act contrary to their personal well being.”

Democracy and prosperity aren't necessarily connected, particularly if you define prosperity only in terms of economic growth, and don't include growth that occurs in civil liberties or quality of life. In fact, Singapore, which has sort of a benign, polite, one-party authoritarian regime, is doing better economically than the world's largest democracy, India, which is awash in caste poverty. India is a democracy with poor policies, whereas Singapore - and Korea, too, for that matter - undertook significant economic reforms as essentially one-party states.

Backward thinking, stupidity and greed are appealing explanations for the economic failures of the world, but they almost certainly are inadequate explanations."

This indicates that the rule of law, not governance by democratic means, is the most important factor in determining a nation's growth. To bring this about, fledgling governments need to recognize that political order is a public good that must be carefully constructed, and to focus on this critical goal.

The rule of law, which includes an assurance of both property rights and investments, is actually more important than democratic institutions themselves. Based on the comparative growth rates of Latin America and the United States after their revolutions, it is clear that stability promotes growth, particularly when combined with political consensus and political and economic freedom.

## Democracy Is Not Enough

India is a prime example of why democracy isn't enough, and why democratic institutions don't automatically translate into economic growth. India's free competitive elections seem to be accompanied by economic policies that foster poverty and social unrest rather than peace and prosperity.

“Political arrangements create incentives for political leaders to foster growth or to steal their nation's prospects for prosperity. How to govern for prosperity is likely to be the most important policy puzzle of the twenty-first century.”

One of India's main problems is its corrupt patronage system, which undermines both market efficiency and competition. Furthermore, real political competition does not exist in the patronage system, which encourages special privileges, access to graft and bribes, tax loopholes, sweetheart deals for cronies and judicial favoritism. Candidates who are committed to reforming the public

sector in India do not win elections.

“Given the state of knowledge about the economics of growth, the solution to poverty lies in the construction of political institutions that provide leaders with incentives to focus on the welfare of their citizens”

Contrast India’s slow economic growth with the rapid growth of a number of Asian countries, which have had much faster growth rates but much less democracy. The Indian patronage system seems to have no checks or balances. However, the Malaysian Business Council, the Economic Trend Review in South Korea, the state-sponsored industrial associations in Taiwan and the National Wages Council in Singapore all have facilitated a broad-based consensus for growth among their constituent governments, business interests and labor. These bodies minimize friction and polarization among their member groups and add cohesion to their national economies.

Many Asian countries have a more developed sense of the goal of shared wealth than is found in other places. This consensus is critical because economic growth declines in countries in which income inequality increases.

## **The Shadow of Monarchy**

The roots of economic growth also seem to spring from a nation’s pre-revolutionary history. Apparently, the nature of the former oppressor affects successful economic advancement.

“Although most economists ignore problems of disorder, creating order is a task necessary to establishing foundations of long term economic growth.”

A case study contrasting the growth of Latin America and the United States, found that even though Latin American revolutions and the United States Revolutionary War all overthrew monarchies, the United States benefited more than the Latin American countries. This is because the English rule overthrown by the U.S. had allowed considerable economic and political freedoms. On the other hand, the Spanish monarchy was greedy and inefficient. It left no useful society-building institutions for Latin America to use in its future growth.

“Disorder occurs when: Rights and privileges of individuals and organizations are up for grabs, implying disruption of existing exchange relationships in both economic and political markets.”

After independence, most of Spain’s former colonies on the mainland imploded in costly and deadly pronunciamientos (organized revolts against the government) and caudillismo (the political phenomenon of local or regional political bosses who have a comparative advantage in the use of violence).

These conflicts were destructive, but being rooted in the independence struggles over early republican state building, [they] diverted capital and labor from production and consigned the new nations to a path of stunningly poor performance in comparison to the United States. These nations lacked the strong institutional underpinnings that the United States already possessed when it created a stable democracy and began its climb toward becoming the world’s richest economy.

## **Foundations for Growth**

These foundations included the Constitution, which replaced the Articles of Confederation, both distantly rooted in the English Magna Carta. The U.S. also had the bulwark of a stable, well-specified system of economic and political rights that provided the credible commitment that was a necessary prerequisite to efficient economic markets.

“A system of order has the following characteristics: an institutional matrix that produces a set of organizations and establishes a set of rights and privileges.”

During the late eighteenth and the first half of the nineteenth century, the United States created a stable political democracy and was well on its way to becoming the richest economy in the world.

Subsequently, the United States retains a robust system of federalism, democracy, limited government and thriving markets, while

much of Latin America retains incompletely secured democracy and questionable foundations for citizen rights and free markets - all because of the unfortunate but lingering influence of the destructive colonial Spanish monarchy.

## Democracy and The Rule of Law

Although it is somewhat controversial, it seems clear that the rule of law and property rights are key determinants of economic growth and investment, but even those two determinants deliver mixed results in democracies.

“Destructive conflict consigned the new nations (in Latin America) to a path of stunningly poor performance in comparison to the United States.”

The rule of law makes it possible for businesses to thrive, because they can guarantee enforceable contracts and such, while ensuring that investors are putting their money into stable markets. Logically, businesses require predictable legal environments. Disquietingly, big businesses might be more willing to put their money into Pinochet’s Chile or Somoza’s Nicaragua rather than into chaotic but democratic India. Although it is unpleasant to think so, once an intermediate level of democracy has been attained, the further expansion of democracy seems to come at the expense of economic performance.

Economists provide economic policy solutions that are tried, tested and true for promoting prosperity, but they rarely confront the political incentives that block economic reform.

## The Romance of Democracy

The focus of American foreign policy has been to support free elections with multiple parties at all times, although it may not always be in the best interests of the United States to push for democracy everywhere.

“Recent empirical research supports the idea that property rights and the rule of law are key determinants of economic growth and investment but delivers mixed results with respect to the contributions from democracy.”

Democracy itself is not a bad thing, but impoverished countries are not in a position to sustain democracy without the support of the other sustaining institutions that go along with successful democracy.

But would the U.S. be better off supporting short-term dictators for economic reasons, instead of following the romance of democracy? Look at two contrasting case histories for an indication of the impact of U.S. actions in this regard.

When Haiti was run by a military dictator, the United States intervened to restore the previously elected president, despite his doubtful credentials. When President Fujimori of Peru disbanded the country’s legislature and assumed dictatorial powers - ostensibly temporarily - to counter a terrorist threat and to enact drastic economic and political reforms, the United States complained bitterly. Perhaps the U.S. would have better served the populations of those countries either by not intervening or by diplomatically simply expressing its displeasure about oppressive behavior.

## Policy Ramifications of Foreign Aid

The remaining issue, which is a function of these aforementioned policy areas, is the question of what type of aid should developed nations give to poorer countries. Giving money to governments that are known for their corruption and propensity for theft is not a practical way to distribute benefits to the populace.

Therefore, serious grant and relief funding should be sent through multiple channels, particularly private ones, if possible. In other words, use the Red Cross and not Boris Yeltsin if you want to funnel relief money into Russia.

Apolitical expertise and apolitical international assistance do not exist. Heavily concentrating control over development assistance in a few hands creates negative motives. In fact, this kind of distribution encourages leaders to use the money at hand to reward their cronies and fellow bureaucrats with cash payouts and lucrative perks, and to ensure their own longevity in office.

Politically, it is meaningful to recognize that in much of the world, fixing the macroeconomic environment alone would result in the

ouster of the incumbent political leadership. Leaders, then, sensibly are slow in implementing economic interests that they do not control.

## About the Authors

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